(m)

No. 94-967-CFX
Status: GRANTED

Title: William Field and Norinne Field, Petitioners
v.
Philip W. Mans

Docketed:
November 25, 1994

Court: United States Court of Appeals for
the First Circuit

Counsel for petitioner: Seufert,Christopher J.

Counsel for respondent: Mans,Philip W., Whittington IV,W.E.

Docket fee rcd 11-30-94.

Entry	Date	Note	Proceedings and Orders
1	Nov 25 1994	G	Petition for writ of certiorari filed.
2	Jan 4 1995		DISTRIBUTED. January 20, 1995 (Page 2)
3	Jan 17 1995	P	Response requested -- JPS. (Due February 17, 1995)
5	Feb 1 1995		Order extending time to file response to petition until March 3, 1995.
6	Mar 6 1995		Order further extending time to file response to petition until April 2, 1995.
7	Apr 12 1995		REDISTRIBUTED. April 28, 1995 (Page 1)
8	May 1 1995		Petition GRANTED.
			***
9	May 18 1995		Record filed.
		*	Partial record proceedings United States Court of Appeals for the First Circuit.
10	May 19 1995		Record filed.
		*	Certified record proceedings United States District Court for the District of New Hampshire.
11	Jun 15 1995		Brief amicus curiae of United States filed.
14	Jun 15 1995		Joint appendix filed.
15	Jun 15 1995		Brief of petitioners William Field, et ux. filed.
12	Jun 16 1995	G	Motion of respondent for leave to proceed further herein in forma pauperis filed.
13	Jun 16 1995	G	Motion of respondent for appointment of counsel filed.
16	Jun 20 1995	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
17	Jun 26 1995		Motion of respondent for leave to proceed further herein in forma pauperis GRANTED. ent filed.
18	Jun 26 1995		Motion for appointment of counsel GRANTED and it is ordered that W. E. Whittington IV, Esquire, of Norwich, Vermont, is appointed to serve as counsel for the respondent in this case.
19	Jul 13 1995		Brief of respondent Philip W. Mans filed.
20	Jul 17 1995		Brief amicus curiae of Natl. Assn. of Consumer Bankruptcy Attorneys for the U.S. filed.
21	Aug 2 1995		SET FOR ARGUMENT MONDAY, OCTOBER 2, 1995. (3ND CASE).
22	Aug 4 1995		CIRCULATED.
23	Sep 13 1995		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
24	Oct 2 1995		ARGUED.

1pp

Supreme Court, U.S.
FILED

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CASE #________________

SUPREME COURT OF THE
UNITED STATES OF AMERICA

1994 TERM

WILLIAM FIELD AND NORINNE FIELD

v.

PHILIP W. MANS

PETITION FOR CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

PETITION FOR WRIT OF CERTIORARI

Christopher J. Seufert, Esq.
Counsel of Record
Seufert Professional Assoc.
59 Central Street
Franklin, NH 03235
(603) 934-9837

47pp

QUESTION PRESENTED FOR REVIEW

Given that 11 U.S.C. § 523 (a)(2)(A) requires proof that creditors rely on a debtor's fraudulent actions in order that a debt be excepted from discharge in Bankruptcy under 11 U.S.C. § 523 (a)(2)(A), and given that the Bankruptcy Court has found fraud and reliance by the creditor upon the debtor's misrepresentations, is it also necessary that the creditor prove that its reliance upon the fraudulent misrepresentation was reasonable?

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OFFICIAL AND UNOFFICIAL REPORTS OF OPINIONS DELIVERED IN THIS CASE BY OTHER COURTS

United States Bankruptcy Court for the District of New Hampshire BK #90-12385 Chapter 7 Adv. #91-1194 Judgment #46 Book 4 unpublished opinion, final judgment dated May 11, 1993.

United States District Court for the District of New Hampshire C-93-41-L, unpublished order dated December 7, 1993.

Civil Action #1:93-CV-0041-L, United States District Court for the District of New Hampshire judgment dated January 27, 1993, on order of December 7, 1993.

United States District Court for the District of New Hampshire, C-93-401-L, order dated March 22, 1994.

United States Court of Appeals for the First Circuit 94-1391 unpublished opinion dated August 29, 1994.

GROUNDS ON WHICH JURISDICTION OF THE UNITED STATES SUPREME COURT IS INVOKED

This is an appeal of the judgment entered August 29, 1994 by the United States Court of Appeals for the First Circuit, affirming the judgment of the United States District Court for the District of New Hampshire dated December 7, 1993, affirming the decision of the United States Bankruptcy Court dated May 11, 1993, finding the debt of the defendant to the plaintiffs to be dischargeable in Bankruptcy.

Certiorari is sought in accordance with 28 U.S.C. §1254 (1) and United States Supreme Court Rules Rule 10.1(a) and 10.1(c).

CONSTITUTIONAL AND STATUTORY PROVISIONS

UNITED STATES CONSTITUTION ARTICLE I, SECTION 8:

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

To borrow Money on the credit of the United States;

To regulate Commerce with Foreign Nations, and among the several States, and with the Indian Tribes;

To establish an uniform Rule of Naturalization, and uniform Laws on the subject to Bankruptcies throughout the United States; ...

28 U.S.C. § 1254

Cases in the Courts of Appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

(2) By certification at any time by a Court of Appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

11 U.S.C.A. § 523 (a)(2)(A) (West 1994)

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual from any debt --

> (2) for money, property, or services, or an extension, renewal, or refinancing or credit, to the extent obtained, by --
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; ...

11 U.S.C.A. § 523 (a)(2)(B) (West 1994)

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) or this title does not discharge an individual from any debt --

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UNITED STATES CONSTITUTION ARTICLE I, SECTION 8:

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(2) for money, property, or services, or an extension, renewal, or refinancing of credit, to the extent obtained, by --

(B) use of a statement in writing --

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied;

(iv) that the debtor caused to be made or published with intent to deceive;
...

UNITED STATES SUPREME COURT RULES:

RULE 10 Considerations Governing Review on Writ of Certiorari

.1 A review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only when there are special and important reasons therefor. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons that will be considered:

(a) When a United States court of appeals has rendered a decision in conflict with the decision of another United States court of appeals on the same matter; or has decided a federal question in a way in conflict with a state court of last resort; or has so far departed from the accepted and usual course of judicial proceedings, or sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision.
...

(c) When a state court or a United States court of appeals has decided an important question of federal law which has not been, but should be, settled by this court, or has decided a federal question in a way that conflicts with applicable decisions of this Court.

...

STATEMENT OF THE CASE

In June, 1986 the plaintiffs, William and Norinne Field (Fields) sold real estate to an entity wholly owned by the defendant, Philip Mans (Mans) and were paid approximately $275,000.00 cash and were given a promissory note in the amount of $187,500.00. The note was guaranteed by Mans, and was secured by a second mortgage on the property which was duly recorded at the Registry of Deeds. (The mortgage was junior to a mortgage to Mascoma Savings Bank.) The mortgage prohibited the defendant from conveying the property without the prior written consent of the plaintiffs, and further stated that, on such a sale, the whole of the remaining indebtedness secured by the mortgage would, at the option of the holder of the mortgage, be immediately due and payable. On or about October 8, 1987, in direct violation of these terms of the mortgage, Mans caused a transfer of title of the mortgaged property to a partnership known as Crescent Beach Development ("Crescent Beach").

The transfer, pursuant to the terms of the mortgage, triggered the due-on-sale clause, but the plaintiffs were unaware that the transfer had taken place. In fact, Mans had intentionally concealed the transfer in such a way as to defraud the plaintiffs, by sending a letter purportedly seeking permission for the transfer, AFTER the transfer was

nearly complete. Specifically, the letter, dated October 8, 1987, advised the Fields that Mans had taken on a partner in the development of the property. The letter further went on to say:

> Obviously we do not want to trigger the "due-on-sale" clause by reason of the transfer of the property into the development partnership. We ask that Mr. and Mrs. Field, as the holders of the second mortgage, consent in writing to the transfer of the property.

The Fields responded by letter dated October 19, 1987. Among other conditions, they stated that they would approve the transfer if they received a payment of $10,000.00. Mans, through counsel, responded on October 27, 1987 that "the fee of $10,000.00 is out of the question." However, Mans in this October 27, 1987 correspondence did not disclose to the Fields that the transfer had actually already taken place despite the lack of consent.

The Fields, subsequent to the undisclosed transfer, continued to receive payments on the note through November, 1990. No further payments were forthcoming, and the Fields received notice of Mans' voluntary bankruptcy petition in December of 1990. The Mascoma Bank foreclosed on

the property on or about June 7, 1991, netting their first mortgage. No funds were available to satisfy the Fields' second mortgage.

The Fields filed a non-dischargeability complaint against Mans in the Bankruptcy Court under the provisions of 523 (a)(2)(A) arguing that they were "duped" into extending credit (the promissory note) beyond its time period (option to call upon subsequent transfer) by Mans' fraud in obscuring the fact that he transferred the property. Federal Court jurisdiction over this matter was grounded on Article I of the United States Constitution, and Title 11 of the United States Code. After trial, the Bankruptcy Court found that in fact an extension of credit was proven, that actual fraud had taken place and that reliance was proven, but that the plaintiffs failed to prove that their reliance on the fraud was reasonable.

ARGUMENT

The courts are divided as to the issue of whether or not reasonableness of reliance must be proved under § 523 (a)(2)(A).[1] There is also considerable division within some circuits, more notably the 2nd[2] and 11th[3] circuits.

Nothing in the text of § 523 (a)(2)(A) requires that a creditor prove that his reliance on the debtors' fraud was reasonable, as would be a requirement if the plaintiff had chosen to proceed under § 523 (a)(2)(B).

"When interpreting a statute, the starting point is, of course, the language of the statute itself. If the language is clear and unambiguous, and there is no clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." National Freight Inc. v. Larson 760 F. 2d 499, 503 (1985), referencing American Tobacco Co. v. Patterson 456 U.S. 63, 68 (1982) and Consumer Product Safety Commission v. GTE Sylvania, Inc. 447 U.S. 102, 108 (1980).

The language of the statute in question here is clear and unambiguous. § 523 (a)(2)(A) excepts from discharge those debts which are "... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by -- false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; ..." 11 U.S.C.A. § 523 (a)(2)(A) (West 1993).

However, should it be found that the above language is ambiguous regarding the issue of reasonable reliance, one must look to the intent of Congress in enacting the Statute, prior to expanding or narrowing the scope of the statutory exception through judicial interpretation. See U.S. v. Lamp 606 F. Supp. 193, 197 (D.C.W.D. Texas 1985) and Jordan v. Montgomery Ward & Co. 442 F. 2d 78, 81 (8th Cir. 1971).

In Jordan, the Court referenced the Congressional Record to support its conclusion that the language in one section of a statute, allowing for civil actions regarding consumer credit transactions, did not apply to another section of the same statute, concerning credit advertising. In particular, the Court referenced language in the Congressional Record specifically exempting advertising requirements from the private civil relief provision. Jordan at 81.

In reference to 11 U.S.C § 523 (a)(2)(A) and (a)(2)(B), the Congressional Record states specifically that "Subparagraph (A) is mutually exclusive from subparagraph (B)". Congressional Record - House, Daily Edition September 28, 1978, at [H 11096], Congressional Record - Senate, daily Edition October 6, 1978, at [S 17412]. Only § 523 (a)(2)(B) requires proof of reasonable reliance on the part of the creditor, § 523 (a)(2)(A) does not.

The leading case in the area, and the most compelling argument for the proposal that reliance need not be proven to be reasonable to except a debt from discharge under § 523 (a)(2)(A), is IN RE Ophaug 827 F. 2d 340 (8th Cir. 1987). In Ophaug the plaintiffs had lent money to the defendant, who subsequently filed Chapter 11 bankruptcy proceedings. The plaintiffs filed a complaint seeking to have the debt declared non-dischargeable on the grounds that the debtor obtained the loan by knowingly making a false statement to the plaintiffs, on which they relied. The debtor had obtained a loan from the creditors in the amount of $90,000.00, purportedly to purchase farmland. He had pledged to the plaintiffs a security interest in equipment and machinery to secure the debt. Unbeknownst to the creditors, the debtor never had any intention of purchasing land, and had already used

the pledged machinery as collateral for prior obligations. The plaintiffs obtained a state court judgment against the defendant, but the defendant subsequently filed for a Chapter 11 bankruptcy. The Bankruptcy Court found that while the debtor had made misrepresentations, upon which the creditors had relied, the reliance was unreasonable, and therefore the debt was dischargeable. The District Court affirmed. Ophaug at 398.

In reversing the District Court, the 8th Circuit Court of Appeals referred to the unambiguous language of the statute, as well as the stated intent of Congress, (as previously referenced in this petition, see Congressional Record), to support the contention that reasonableness, while a requirement under § 523 (a)(2)(B), is NOT a requirement under § 523 (a)(2)(A). Id. at 401.

In conclusion, the decision of the United States Court of Appeals for the First Circuit is in direct conflict with the decisions of various United States Courts of Appeals on this same issue, making this case an ideal vehicle for addressing this issue and settling the matter of reasonable reliance as it pertains to 11 U.S.C. § 523 (a)(2)(A). In accepting this case, the Court would further the intent of United States Supreme Court Rule 10.1(a) in clearing up the disparity between the circuits,

as well as Rule 10.1(c) since the question is an important question of Federal law which has not been but should be settled by the Court. Acceptance of this case by the Supreme Court would further the intent of Congress that the Bankruptcy laws be uniform throughout the circuits. If this case is not heard by this Court, it is likely that the First Circuit and other circuits will continue to render decisions in conflict with each other and in conflict with the intent of Congress in enacting the Bankruptcy Code.

Respectfully submitted,
William and Norinne Field,
By and through counsel

____
Christopher J. Seufert, Esq.
Counsel of Record

NOTES:

[1]See 97 ALR Fed 402 for analysis.

REASONABLE RELIANCE REQUIRED:

Circuit Courts of Appeals:

IN RE Burgess 955 F. 2d 134
(1st Cir. 1992)

Philips v. Coman 804 F. 2d 930
(6th Cir., 1986)

IN RE Mallet 817 F. 2d 677
(10th Cir. Colo. 1987)

District Courts:

IN RE Hunt 30 BR 425 (MD Tenn. 1983)

IN RE McIntyre 64 BR 27 (D.N.H. 1986)

IN RE Michel 74 BR 88 (N.D. Ohio 1985)

Title Ins. Corp. v. Pitt.
157 BR 585 (E.D. Va. 1991)

Bankruptcy Courts:

IN RE Paolino 89 BR 453
(B.C. E.D. Pa. 1988)

IN RE Wise 6 BR 867
(B.C. MD. Fla. 1980)
(discussing 523(a)(2) in general)

IN RE Ashley 5 BR 262
(B.C. E.D. Tenn. 1980)

Bonosky v. Allen 25 BR 566
(B.C. S.D. Ohio 1982)

IN RE Constantino 72 BR 231
(B.C. N.D. Ohio) later proceeding
80 BR 865

IN RE Cheh 96 BR 781
(B.C. N.D. Ohio 1988)

IN RE Cicero 28 BR 480
(B.C. E.D. Wis. 1983)

IN RE Guy 101 BR 961
(B.C. N.D. Ind. 1988)

IN RE Younesi 34 BR 828
(B.C. C.D. Cal. 1983)

IN RE Howarter 95 BR 180
(B.C. S.D. Cal. 1989)

IN RE Brewood 15 BR 211
(B.C. D.C. Kan. 1981) (disapproved
on other grounds by
Birmingham Trust Nat. Bank v. Case
755 F. 2d 1474
(11th Cir. Ala. 1985))

IN RE Maranzino 67 BR 394
(B.C. D.C. Kan. 1986)

IN RE Anzman 73 BR 156
(B.C. D.C. Colo. 1986)

IN RE Gering 69 BR 686
(B.C. D.C. Kan. 1987)

IN RE Beleau 35 BR 259
(B.C. D. RI 1983)

IN RE Salvatore 46 BR 247
(B.C. D. RI 1984)

Matter of Eaton 41 BR 800
(B.C. E.D. Wis. 1984)

Matter of Weinstein 31 BR 804
(B.C. E.D. NY 1983)

IN RE Gonzalez Seijo 76 BR 11
(B.C. D. PR 1987)

IN RE Waning 120 BR 607
(B.C. D. Me. 1990)

IN RE Sestito 136 BR 602
(B.C. D. Mass. 1992)

Matter of Haining 119 BR 460
(B.C. D. Del. 1990)

State v. Spicer (B.C. D.C.
Dist. Col. 1993)

ITT Fin. Servs. v. Schoenlein
157 BR 824 (B.C. N.D. Ohio 1993

First Bank Sys., N.A. v. Foley
156 BR 645 (B.C. D.C. ND 1993)

<u>MERE RELIANCE SUFFICIENT:</u>

<u>Circuit Courts of Appeals:</u>

<u>IN RE Ophaug</u> 827 F. 2d 340
(8th Cir. 1987) 97 ALR Fed. 395

<u>Matter of Allison</u> 960 F. 2d 481
(5th Cir. 1992).

<u>Bankruptcy Courts:</u>

<u>IN RE Showalter</u> 86 BR 877
(B.C. W.D. Va. 1988)

<u>IN RE Hamm</u> 92 BR 386
(B.C. W.D. Mo. 1989)

<u>IN RE Kroh</u> 88 BR 972
(B.C. W.D. Mo. 1988)

<u>IN RE Stewart</u> 91 BR 489
(B.C. S.D. Iowa 1988)

<u>IN RE Fosco</u> 14 BR 918
(B.C. D.C. Conn. 1981)

<u>IN RE Sobel</u> 37 BR 780
(B.C. E.D. NY 1984)

<u>IN RE Monahan</u> 125 BR 697
(B.C. D. RI 1991)

<u>IN RE Schwartz and Meyers</u> 130 BR 416
(B.C. S.D. NY 1991)

<u>IN RE McDermott</u> 139 BR 50
(B.C. D. RI 1992)

"Justifiable" rather than "reasonable" reliance required:

<u>IN RE Kursh</u> 973 F. 2d 1454
(9th Cir. 1992).

[2]Reliance required: <u>IN RE Newmark</u> 20 BR 842 (B.C. E.D. N.Y. 1982), <u>IN RE Esposito</u> 44 (BR 817 (B.C. S.D. N.Y. 1984) Reliance not required: <u>IN RE Schwartz & Meyers</u> 130 BR 416 (B.C. S.D. N.Y. 1991), <u>IN RE Fosco</u> 14 BR 918
B.C. D.C. Conn. 1981), and
<u>N RE Sobel</u> 37 BR 780
B.C. E.D. N.Y.)

[3]Reasonable reliance required: <u>IN RE Black</u> 113 BR 79 (B.C. M.D. Fla. 1990). Neutral position re: reasonableness of reliance: <u>IN RE Firestone</u> 26 BR 706 (B.C. S.D. Fla. 1982)

United States Court of Appeals
for the First Circuit

No. 94-1391

WILLIAM FIELD AND NORINNE FIELD,
Plaintiffs, Appellants,

v.

PHILIP W. MANS,
Defendant, Appellee.

JUDGMENT

Entered: August 29, 1994

This cause came on to be submitted on the briefs and original record on appeal from the United States District Court for the District of New Hampshire.

Upon consideration whereof, it is now here ordered, adjudged and decreed as follows: The judgment of the district court is affirmed.

By the Court:

Francis P. Scigliano

Clerk.

United States Court of Appeals
For the First Circuit

No. 94-1391

WILLIAM FIELD AND NORINNE FIELD,
Plaintiffs, Appellants,

v.

PHILIP W. MANS,
Defendant, Appellee.

APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF NEW HAMPSHIRE

[Hon. Martin F. Loughlin,
U.S. Senior District Judge]

Before

Torruella, Chief Judge,
Selya and Cyr, Circuit Judges.

Christopher J. Seufert on brief for appellants.

Philip W. Mans on brief pro se.

August 29, 1994

Per Curiam. Having reviewed carefully the briefs and the record in this case, we affirm the judgment of the district court, affirming the decision of the bankruptcy court denying appellants' request to have the debt of approximately $150,000 of appellee to appellants excepted from discharge under 11 U.S.C. § 523(a)(2)(A).

This circuit has determined that to establish that a debt is nondischargeable under 11 U.S.C. § 523(a)(2)(A) a creditor must prove, inter alia, that his "reliance was reasonable in the circumstances." In re Burgess, 955 F.2d 134, 140 (1st Cir.) 1992). Since we find no clear error, see In re Corporacion de Servicios Medicos Hospitalarios de Fajardo, 805 F.2d 440, 447-48 (1st Cir. 1986) (determination of reasonableness reviewed for clear error), in the finding by the bankruptcy court that the creditors' reliance in this case was not reasonable, the judgment below is affirmed.[1]

[1] In bankruptcy matters, this court conducts an independent review of both the factual and legal findings of the bankruptcy court. In re G.S.F. Corp., 938 F.2d 1467, 1474 (1st Cir. 1991). Therefore, any error committed by the district court in findings of fact during its review of the bankruptcy court decision would be harmless.

THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW HAMPSHIRE

William Field, et. al.

v. #C-93-401-L

Philip W. Mans

ORDER

Before the court is the appellants', William Field and Norinne Field's Motion For Reconsideration (doc #11) and the appellee's, Philip W. Mans, Opposition to Motion For Reconsideration (doc #12). For the reasons stated below, the appellants' motion is denied.

PROCEDURAL HISTORY

Philip W. Mans filed for discharge in bankruptcy pursuant to Chapter 11 in December 1990. The Fields filed to have approximately $150,000.00 of debt excepted from discharge pursuant to 11 U.S.C.S. § 523(a)(2)(A). The case was heard on May 11, 1993 in United States Bankruptcy Court for the District of New Hampshire by Judge Yacos. Judgment was rendered for Mr. Mans with a finding that although the debtor made misrepresentations upon which the creditor relied, the creditor's reliance was not reasonable. This court affirmed the Bankruptcy Court's ruling in a previous order, In re Mans, No. 93-401-L

(D.N.H. December 7, 1993). Mr. Field has filed a Motion For Reconsideration of that Order.

FACTS

Mr. Field asserts that the court cited a conversation between Mr. Field and a Mr. DeFelice which never took place as grounds for its finding that Mr. Fields' reliance on the appellee's misrepresentations was not reasonable. Mr. Field asserts that the conversation which did occur was between a Mr. DeFelice, the man who claimed an ownership interest in the property, and a Mr. Lucido, Mr. Field's employer. Mr. Field later became aware of the conversation when Mr. Lucido told him of it. Mr. Field argues that because the court's finding that Mr. Field's reliance was not reasonable was grounded on an erroneous finding of fact, the court's affirmation of the Bankruptcy Court's Ruling is also erroneous.

DISCUSSION

A district court may reconsider a judgment or order and order relief from same on grounds of mistake or excusable neglect or fraud or general fairness. Fed. R. Civ. P. 60(b). Such motions are "committed to the district court's discretion." FDIC v. Ramirez-Rivera, 869 F.2d 624, 626 (1st Cir. 1989). See Anderson v. Cryovac, Inc. 862 F.2d 910, 923 (1st Cir. 1988).

An error of law or fact by a district court in a civil case does not necessarily mandate automatic reversal. No error or defect in any ruling or order by the court is grounds for vacating or modifying an order, "unless refusal to do so appears to the court inconsistent with substantial justice" Fed. R. Civ. P. 61. The court "must disregard any error or defect in the proceedings which does not affect the substantial rights of the parties." Fed. R. Civ. P. 61. Therefore, assuming that the court did make an error of fact or law, the court need not reverse if the error was harmless.

Technically, Mr. Field is correct. The court did mistakenly refer to a conversation between Mr. Field and a Mr. DeFelice which never occurred. The court's order stated that "the [bankruptcy] court cites Mr. Field's conversation with Mr. DeFelice, the new partner, during which Mr. DeFelice commented that he was the new owner." Order, December 7, 1993, page 7.

The section of the transcript upon which the court relied reads as follows:

> COURT: In that regard, the evidence is that in 1988 -- or first that the Fields -- at least Mr. Field visited the property on numerous occasions to see whether -- and what kind of development Mr. Mans was doing, and that on one occasion, his boss told

> him that he -- the boss had been on the property and had see a Mr. DeFelice who had stated that, quote "I am the new owner," unquote. The evidence also indicates that Mr. Field discussed this with the banker that held the first mortgage on the property and didn't get any information but demonstrates that he knew that DeFelice was claiming to be the owner of the property. Mr. Field apparently in his own mind believed that the property could not have been transferred without his consent which of course as a matter of law is not true.

(Transcript p. 81-82). Further examination of the transcript shows that "boss" does indeed refer to a Mr. Lucido. Mr. Field testified that "Mr. Lucido is my boss. He said he was up on the property ... and he met someone there and they said that they were the new owner, this Mr. DeFelice." (Transcript p. 13).

However, the error does not change the analysis of the court. The essence of the conversation was the same. The effect of the conversation on Mr. Field was the same. Mr. Field became aware that a Mr. DeFelice claimed some sort of ownership interest in the property which lead him to investigate the situation. Specifically, Mr. Field spoke with the Bank and later with Mr. Mans. Given that Mr. Field learned that someone

else claimed a property interest and that Mr. Mans previously had approached him regarding the due on sale clause, it is not reasonable that Mr. Field relied on Mr. Mans' misrepresentation.

The court finds that the error does not affect its analysis of whether Mr. Field's reliance on the misrepresentation was reasonable. The error did not affect any substantial rights of the parties and was thus harmless error. Accordingly, the motion for reconsideration is denied.

CONCLUSION

The appellants' Motion For Reconsideration is denied because the court's error was harmless.

March 22, 1994

/s/
Martin F. Loughlin
Senior Judge

Christopher J. Seufert, Esq.
Philip W. Mans
George Vannah, Clerk
U.S. Bankruptcy Court

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW HAMPSHIRE

Fields

v. Civil Action No. 1:93-CV-00401-L

Mans

J U D G M E N T

JUDGMENT is hereby entered in accordance with Senior Judge Martin F. Loughlin's order dated December 7, 1993. (Signed by Clerk James R. Starr)

By the Court,

/s/Kelly A. Papas

Deputy Clerk

Date: January 27, 1994

cc: David H. Ferber, Esq.
Christopher J. Seufert, Esq.
Steve J. Bonnette, Esq.
Philip W. Mans
George Vannah

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW HAMPSHIRE

In re Philip mans

#C-93-401-L

ORDER

Before the court is the appellants/plaintiffs, William and Norinne Field's, appeal from a Bankruptcy Court ruling issued by Judge James J. Yacos on May 11, 1993. For the reasons stated below, the Bankruptcy Court's ruling is affirmed.

PROCEDURAL HISTORY

Appellee, Philip W. Mans filed for discharge in bankruptcy pursuant to Chapter 11 in December 1990. Appellants filed to have approximately $150,000.00 of debt excepted from discharge pursuant to 11 U.S.C.S. § 523(a)(2)(A). The case was heard on May 11, 1993 in U.S. Bankruptcy Court for the District of New Hampshire by Judge Yacos. Judgment was rendered for the appellee with a finding that even though the debtor made misrepresentations upon which the creditor relied, the creditor's reliance was not reasonable.

FACTS

The appellants, William and Norinne

Field, sold real estate on Mascoma Lake in Enfield, New Hampshire to the appellee, Philip W. Mans. The appellants were paid $275,000.00 in cash and were given a note for $187,500.00. The note was personally guaranteed property. The note was junior to a mortgage held by the Mascoma Savings Bank. The second mortgage contained a due-on-sale clause which stated that in the event that the appellee conveyed the property without the prior consent of the appellants the remaining indebtedness secured by the mortgage would be immediately due and payable at the option of the mortgage holder.

On October 8, 1987, the appellee transferred the property to a newly formed partnership, Crescent Beach Development. On October 9, 1987, the appellee wrote to the appellants informing them that he had brought in an investor and formed the new partnership. The letter stated that the appellee did not want to trigger the due-on-sale clause with a transfer to the development partnership and asked that the appellants consent. On October 19, 1987, the appellants responded by letter which indicated that they would consent to the transfer on several conditions. The appellants wanted $250.00 lost interest due from the previous closing, future payments to be made by direct bank transfer, $250.00 for attorney's fees to negotiate the consent and a $10,000.00 fee.

On October 27, 1987, the appellee agreed to all the terms except the $10,000.00 demand. Bankruptcy was filed over three years later on December 10, 1990; however, no further correspondence passed between the parties until February 6, 1991 at which time the appellants' attorney informed them that he had researched the deed and discovered the transfer.

The Bankruptcy Court found that the letters from the appellee to the appellants did contain an implicit misrepresentation: the property had not yet been transferred. The court also found that the appellants did rely upon this representation and thereby extended credit to the appellee when they could have called the due-on-sale clause as of October 1987. Lastly, the court found that the appellants' reliance on the misrepresentations was not reasonable.

The issue on appeal is whether reasonable reliance on a debtor's fraudulent actions, statements, or misrepresentations is an element in excepting a debt from discharge in bankruptcy pursuant to 11 U.S.C.S. § 523(a)(2)(A) and if so, whether it was it clearly erroneous to find that the creditor's reliance on the debtor's misrepresentations was unreasonable.

DISCUSSION

In an appeal from a bankruptcy court's decision, a district court "may affirm, or reverse a bankruptcy judge's judgment." Bankr. Proc. Rule 8013. A district court reviews the bankruptcy court's determination of law by de novo review, In re Navigation Technology Corp., 880 F.2d 1491, 1493 (1st Cir. 1989), and the bankruptcy court's findings of fact using the clearly erroneous standard. Biden v. Foley, 776 F.2d 379, 381 (1st Cir. 1985). A finding is clearly erroneous when, "'although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.'" In re McIntryre, 64 B.R. 27, 29 (D.NH 1986) quoting D. Federico Company v. New Bedford Redevelopment Authority, 723 F. 2d 122, 126 (1st Cir. 1983).

Appellants argue in their brief that a division exists in the First Circuit as to whether reasonable reliance is an element of non-dischargeability of debt under the bankruptcy code. That assertion is incorrect.

The First Circuit Court of Appeals has stated that "reasonable" reliance is an element in proving nondischargeable debt under 11 U.S.C. § 523(a)(2)(A). In In re Burgess, 955 F.2d 134, 140 (1st Cir. 1992), the court held that under

11 U.S.C. § 523(a)(2)(A) one of the elements the creditor was required to prove was that "the creditor's reliance was reasonable in the circumstances." Also, the court stated that statutory requirements for discharge in bankruptcy must be construed liberally in favor of the debtor and reasons for denying discharge must be real and substantial, not merely technical and conjectural. Burgess, 955 F.2d at 137.

Appellants rely substantially upon two Rhode Island district court cases, In re Monahan, 125 B.R. 697 (Bkrtcy.D.R.I. 1991) and In re McDermott, 139 B.R. 50 (Bkrtcy.D.R.I. 1992), as support for their argument that the first circuit is divided on the issue of "reasonable" reliance. In Monahan, the court held that reasonable reliance was limited to causes of action under § 523(a)(2)(B) and not subsection (A). Monahan, 125 B.R. at 699. The court stated that the four elements listed in the statute are all that are needed to state a § 523(a)(2)(A) claim, and rejected those cases which included the additional requirement of reasonable reliance. Monahan, 125 B.R. at 699. The court justified its position by adding that the policy of liberally interpreting exceptions to discharge was not meant to protect a dishonest debtor. Monahan, 125 B.R. at 700. In McDermott, the court followed Monahan and noted that reasonable reliance by

the creditor is not required under § 523(a)(2)(A). McDermott, 139 B.R. at 52, n.5.

However, both of these are district court opinions which were decided the year before and the year of In re Burgess respectively. As the Court of Appeals for the First Circuit has since ruled conclusively in In re Burgess, the two Rhode Island cases indicate no division on the issue of reasonableness.

Appellants also claim that in In re Lane the First Circuit Court of Appeals declined to take a position on the issue of reasonable reliance as a required element of a § 523(a)(2)(A) claim. 937 F.2d 694 (1st Cir. 1991). Appellants argue that this indicated a move away from the reasonable reliance requirement in the First Circuit. However, the First Circuit Court of Appeals did in fact take a position in In re Burgess, which states quite clearly that reasonable reliance is an element. Burgess, 955 F.2d at 140.

Two additional distinctions may also be made. The Lane court did concede in a footnote that not all courts require the reasonable reliance element and offered as example In re Ophaug, 827 F.2d 340, 342-43 and n.1 (8th Cir. 1987). Lane, 937 F.2d at 698. However, the Lane court declined to take a position because the record did adequately aver reasonable reliance.

Lane, 937 the record did adequately aver reasonable reliance. Lane, 937 F.2d at 698, n.8. Also, the Lane Court was applying New York substantive law. Lane, 937 F.2d at 696, n.3. As appellants note in their brief, there is considerable division within some circuits, "most notably the second and eleventh circuits." Appellant's br. at 10.

The court must now examine whether the bankruptcy court's finding that the appellants' reliance on the appellee's misrepresentations was reasonable under the circumstance. Burgess, 955 F.2d at 140. On review of the record below, the bankruptcy judge's ruling was not clearly erroneous.

Appellants claim that the court's ruling is inconsistent with determinations of fact and other statements made by the court during trial. Appellants base this contention on several statements made by the bankruptcy judge during trial. Specifically, the judge stated that "the letters obviously would tell anybody, layman or lawyer alike, that you hadn't yet transferred it. That's a necessary implication of it." (Tr. at 66). The court also stated at trial that "[t]hose letters would imply to a layman, that you hadn't yet transferred it and you're asking for his consent." (Tr. at 67). However, this is not inconsistent with the court's ultimate ruling that Mr.

Field's reliance was not reasonable.

The court stated the issue boiled down to the question of reasonable reliance. (Tr. at 81). However, the court did not find it unreasonable to rely on the fact that the appellee had to the appellee seeking permission to transfer the property without invoking the due-on-sale clause. (Tr. at 83). The court found it was unreasonable to rely on the fact that the appellee would not transfer the property absent the appellants' consent. The court specifically found that "there's no statement in the letters that could be read as saying we will never transfer the property without your consent." (Tr. at 83). The court supported its determination of unreasonable reliance with several instances where the appellants could have determined they needed to check on the status of property ownership. Specifically, the court cites Mr. Field's conversation with Mr. DeFelice, the new partner, during which Mr. DeFelice commented that he was the new owner. (Tr. at 81-2). This statement prompted Mr. Field to check with the bank. (Tr. at 82). The court stated that "at a minimum., a prudent man, I think, would have asked his attorney." (Tr. at 85).

CONCLUSION

The bankruptcy court's ruling is affirmed because reasonable reliance is a requirement element to find nondischargeable debt pursuant to 11 U.S.C. § 523(a)(2)(A) and because the record supports the finding that the appellants' reliance on the appellee's misrepresentations was not reasonable.

December 7, 1993

/s/
Martin F. Loughlin
Senior Judge

Christopher J. Seufert, Esq.
Philip W. Mans
U.S. Bankruptcy Court

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE

In re:
Philip W. Mans, BK No. 90-12385
Debtor Chapter 7

William and Norinne Field
Plaintiffs ADV No. 91-1194
Jgmt. #46
Book #4

v.

Philip W. Mans,
Defendant

FINAL JUDGMENT

This adversary proceeding came on for trial on May 11, 1993 and the Court have dictated its findings and conclusions into the record which are incorporated herein by reference, hereby orders as follows:

1. Judgment is hereby entered for the Defendant, Philip W. Mans, finding the debt in question dischargeable.

2. Each party shall bear their own fees and costs.

DONE and ORDERED this 11th day of May, 1993 at Manchester, New Hampshire.

/s/
JAMES E. YACOS
BANKRUPTCY JUDGE

No. 94-967

In the Supreme Court of the United States

OCTOBER TERM, 1994

WILLIAM FIELD AND NORRINE FIELD, PETITIONERS

v.

PHILIP W. MANS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

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QUESTION PRESENTED

Section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. 523(a)(2)(A), does not permit a debtor to discharge a debt incurred by "false pretenses, a false representation, or actual fraud." The question presented is whether creditors who rely on a fraudulent misrepresentation and who invoke Section 523(a)(2)(A) to resist the discharge of a debt must also prove that their reliance on the debtor's misrepresentation was reasonable.

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v.

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ON WRIT OF CERTIORARI
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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

INTEREST OF THE UNITED STATES

This case concerns the showing that a defrauded creditor must make, pursuant to 11 U.S.C. 523(a)(2)(A), in order to prevent the discharge in bankruptcy of a debt incurred by fraud. That question is of interest to the United States because agencies of the federal government frequently oppose the discharge of debts under Section 523(a)(2)(A).[1] The United States also has an interest in

[1] See, *e.g.*, *In re Foust*, 52 F.3d 766 (8th Cir. 1995); *In re Daily*, 47 F. 3d 365 (9th Cir. 1995); *In re Turner*, 179 B.R. 273 (Bankr. D. Colo. 1995); *In re Calhoun*, 131 B.R. 757 (Bankr. D.D.C. 1991); *In re Davis*, 116

opposing a rule that imposes an additional, unwarranted burden on victims of fraud.

The United States often obtains money judgments under federal anti-fraud statutes, such as the False Claims Act, 31 U.S.C. 3729-3731 (1988 & Supp. V 1993), against individuals who subsequently file for bankruptcy. The rule adopted by the court of appeals in this case that, in order to prevent the discharge of a fraudulently incurred obligation a creditor must prove that its reliance on the debtor's misrepresentation was reasonable, may impair the government's ability to collect such judgments and, therefore, its ability fully to enforce civil anti-fraud statutes.

In addition, the government frequently participates in bankruptcy proceedings as a receiver for a defrauded creditor, or as guarantor or insurer of a defrauding debtor's obligation.[2] Where the government pursues a claim in bankruptcy that it acquired as a receiver or assignee of the original creditor, its distance from the facts surrounding the fraudulent transaction, and the need to utilize witnesses with interests adverse to the government, will often make the requirement of proving reasonable reliance particularly onerous.

B.R. 306 (Bankr. M.D. Ga. 1990); *United States* v. *Singleton*, 91 B.R. 604 (Bankr. N.D. Fla. 1988).

[2] See, *e.g.*, 12 U.S.C. 1821(d)(2)(A)(i) (Supp. V 1993) (granting Federal Deposit Insurance Corporation, as receiver, all legal "rights, titles, powers, and privileges" of closed national and district banks); 12 U.S.C. 1709(b) (1988 & Supp. V 1993), 1710(a) (Supp. V 1993) (providing, respectively, for insurance of mortgages by, and assignment of mortgagee's claims to, Department of Housing and Urban Development under National Housing Act).

STATEMENT

Petitioners sold real estate to respondent for $275,000 in cash and a second mortgage note for $187,500. Pet. App. 24. The second mortgage contained a due-on-sale clause, under which the entire remaining obligation would become immediately payable if respondent conveyed the property without petitioners' consent. *Ibid.* On October 8, 1987, respondent triggered the due-on-sale clause by transferring the property to a newly formed partnership, Crescent Beach Development, without petitioners' knowledge. *Ibid.* On October 9, 1987, respondent wrote to petitioners asking them to waive the due-on-sale clause, but did not inform them that he had already transferred the property. *Ibid.* In response, petitioners informed respondent that they would waive the due-on-sale clause in return for $250 for lost interest due from the previous closing, $250 for attorney's fees, and an additional fee of $10,000. *Ibid.* On October 27, 1987, respondent made a counter offer, agreeing to the two $250 payments, but rejecting the requested $10,000 fee. In advancing his counter offer, respondent again failed to inform petitioners that he had already transferred the property. *Id.* at 25. Petitioners did not respond to respondent's counter offer, and no further correspondence occurred between the parties for over three years. *Ibid.*

On December 10, 1990, respondent filed a petition in the United States Bankruptcy Court for the District of New Hampshire seeking relief under Chapter 11 of the Bankruptcy Code.[3] Petitioners did not learn of the October

[3] Chapter 11 provides for the reorganization of business enterprises. Respondent's bankruptcy proceeding was subsequently converted to one for liquidation under Chapter 7 of the Code. Letter from respondent to Francis J. Lorson, Chief Deputy Clerk (Jan. 30, 1995). That conversion

8, 1987, property transfer until February 6, 1991, when their attorney informed them that he had researched the deed to the property and discovered the transfer. Pet. App. 25. Petitioners then filed a complaint in the bankruptcy proceeding, asserting that approximately $150,000 of respondent's second mortgage debt should be exempted from discharge pursuant to Section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. 523(a)(2)(A), as a debt incurred through fraud. Pet. App. 23.[4]

The bankruptcy court held that the debt was dischargeable. The court agreed with petitioners that respondent's letters requesting a waiver of the due-on-sale

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should have no effect on the issues before this Court. Cf. *Toibb* v. *Radloff*, 501 U.S. 157, 160-166 (1991) (discussing the scope of Chapters 7 and 11).

[4] Section 523 provides, in pertinent part:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> * * * * *
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> (B) use of a statement in writing —
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive[.]
>
> * * * * *

clause without disclosing the property transfer were false representations, and that petitioners relied on those representations to their detriment by continuing to extend respondent credit when they could have demanded full payment as of October, 1987. Pet. App. 25. The court concluded, however, that petitioners' reliance was unreasonable under the circumstances, and that the debt was, therefore, ineligible for exception from discharge under Section 523(a)(2)(A). Pet. App. 25.

The district court affirmed. Pet. App. 22-31. It held that the question whether a creditor must prove that he reasonably relied on a debtor's misrepresentation in order to prevent a discharge pursuant to Section 523(a)(2)(A) was settled in the affirmative by the First Circuit's decision in *In re Burgess*, 955 F.2d 134 (1992). Pet. App. 28-29. After reviewing the transcript of the relevant bankruptcy court hearing, the district court concluded that the record supported the bankruptcy court's finding that petitioners' reliance on respondent's misrepresentation was not reasonable. In the district court's view, information available to petitioners should have prompted them to investigate the property's ownership. *Id.* at 30. The district court subsequently denied petitioners' motion for reconsideration under Federal Rule of Civil Procedure 60(b). Pet. App. 17-21. The court of appeals affirmed in a brief, unpublished opinion, relying on its decision in *In re Burgess*. *Id.* at 14-16.

SUMMARY OF ARGUMENT

A. Introduction of a requirement of proof of reasonable reliance in cases arising under Section 523(a)(2)(A) is contrary to the language and structure of the Bankruptcy Code. While Congress expressly required a showing of reasonable reliance to prevent discharge induced by a false written statement "respecting the debtor's or an insider's

financial condition" under Section 523(a)(2)(B), no similar requirement appears in the text of Section 523(a)(2)(A). Judicial importation of a reasonable reliance requirement in cases arising under Section 523(a)(2)(A) would remove an essential and explicit difference between the two provisions. Such a construction would also render the requirement of reasonable reliance in subparagraph (B) cases superfluous, in contravention of the well-established principle that courts should "avoid a reading which renders some words altogether redundant." *Gustafson* v. *Alloyd Co.*, 115 S. Ct. 1061, 1069 (1995).

B. The legislative history of Section 523(a)(2) confirms that Congress intended to confine the requirement of proof of reasonable reliance to subparagraph (B). When Congress reexamined the old Bankruptcy Act in 1978, it divided former Section 17(a)(2) of the Act into subparagraphs 523(a)(2)(A) and 523(a)(2)(B) of the new Code. That division, and the introduction of a requirement of proof of reasonable reliance in subparagraph (B), was intended to address a problem of creditor abuse that had arisen with respect to fraud claims based on technically incomplete written financial statements submitted by borrowers to finance companies. H.R. Rep. No. 595, 95th Cong., 1st Sess. 130-131 (1977). Congress did not include a proof of reasonable reliance requirement in subparagraph (A) because the problem it sought to address did not extend to the general fraud cases covered by that provision. *In re Ophaug*, 827 F.2d 340, 343 (8th Cir. 1987); 124 Cong. Rec. 32,399 (1978) (statement of Rep. Edwards) ("Subparagraph (A) is mutually exclusive from subparagraph (B). Subparagraph (B) pertains to the so-called false financial statement."). Judicial creation of an additional required element of proof in Section 523(a)(2)(A) cases would undermine Congress's policy judgment that victims of fraud should generally be

protected against discharge without having to prove that their reliance on a fraudulent statement was reasonable.

C. The introduction of a reasonable reliance requirement into Section 523(a)(2)(A) would also be contrary to the policy judgments that underlie the Code. The Code's "fresh start" principle is intended to shield the "honest but unfortunate" debtor from the crushing burden of pre-existing debt. *Brown* v. *Felsen*, 442 U.S. 127, 128 (1979). Where, as here, Congress has exempted from discharge debts incurred through debtor fraud, that principle does not apply.

D. Finally, the court of appeals' ruling on this question of federal statutory construction cannot be justified by common law principles of fraud. The textual and historical indicia of congressional purpose discussed above make resort to the common law inappropriate.

ARGUMENT

SECTION 523(a)(2)(A) OF THE BANKRUPTCY CODE DOES NOT REQUIRE A DEFRAUDED CREDITOR TO PROVE "REASONABLE RELIANCE" IN ORDER TO PREVENT THE DISCHARGE OF A FRAUDULENTLY INCURRED DEBT

The court of appeals in this case held that creditors like petitioners, who rely in good faith on the fraudulent misrepresentations of dishonest debtors, may not recover debts so incurred unless they can also demonstrate that their reliance was "reasonable in the circumstances." Pet. App. 16 (quoting *In re Burgess*, 955 F.2d 134, 140 (1st Cir. 1992)). That holding is incorrect. The language, structure, and legislative history of Section 523(a)(2), and the equitable principles that underlie the Bankruptcy Code, indicate that a defrauded debtor in petitioners' position is not required to prove that its reliance on the fraudulent

misrepresentation was reasonable as well as that it was in good faith.

A. The Language And Structure Of The Bankruptcy Code Demonstrate That Proof Of Reasonable Reliance Is Not An Element Of A Defrauded Creditor's Burden In Disputes Arising Under Section 523(a)(2)(A)

Section 523(a)(2) exempts two categories of fraudulently incurred obligations from discharge in bankruptcy. Subparagraph (A), at issue here, exempts debts obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition," and contains no further qualification. 11 U.S.C. 523(a)(2)(A). Subparagraph (B), in contrast, exempts debts obtained by "use of a statement in writing * * * (i) that is materially false; (ii) respecting the debtor's or an insider's financial condition; (iii) *on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied*; and (iv) that the debtor caused to be made or published with intent to deceive." 11 U.S.C. 523(a)(2)(B) (emphasis added). Thus, while subparagraph (B) expressly requires that a creditor prove that its reliance on the fraudulent statement was "reasonable," subparagraph (A) contains no such requirement.

The language of these two provisions clearly limits application of the reasonable reliance requirement to cases arising under subparagraph (B). See *Patterson* v. *Shumate*, 504 U.S. 753, 758 (1992) (comparing parallel provisions of Bankruptcy Code to determine meaning of statutory language); *Toibb* v. *Radloff*, 501 U.S. 157, 161 (1991) (same). The text of Section 523(a)(2)(B)(iii) demonstrates that Congress well knew how to require proof of reasonable reliance when that was its intent. It chose to do so, however, only as to the category of written statements

misrepresenting a debtor's or an insider's financial condition. See *In re Mayer*, 51 F.3d 670, 675 (7th Cir. 1995) ("Congress deliberately distinguished the criteria for discharge according to the kind of document in which the falsehood appears."). Short of affirmatively prohibiting consideration of the reasonableness of reliance under subparagraph (A), we can think of no way in which Congress could more clearly have limited the application of that requirement to the financial statement category of cases.

By requiring an element of proof under subparagraph (A) that is not required by the statutory text, the court of appeals also ignored the principle that, "[i]n construing a statute [courts] are obliged to give effect, if possible, to every word Congress used." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979). See also *United States* v. *Menasche*, 348 U.S. 528, 538-539 (1955); 2A N. Singer, *Sutherland Statutory Construction* § 46.06, at 119 (rev. 5th ed. 1992). If the court of appeals' construction were correct, the express inclusion of a reasonable reliance requirement in Section 523(a)(2)(B)(iii) would be rendered superfluous.[5]

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[5] As the Seventh Circuit pointed out in *In re Mayer*, 51 F.3d 670, 674-675 (1995), subparagraph (B) also contains an express requirement of proof of a debtor's "intent to deceive" that does not appear in subparagraph (A). Subparagraph (A), however, contains the phrase "actual fraud." The legislative history of Section 523(a)(2) indicates that Congress intended to require proof of scienter under both subparagraphs. It did so in subparagraph (B) by including the term "intent to deceive," and in subparagraph (A) by including the term "actual fraud." See 124 Cong. Rec. 33,998 (1978) (comments of Sen. DeConcini) ("Subparagraph (A) is intended to codify current case law *e.g.*, *Neal* v. *Clark*, 95 U.S. 704 (1887) [*sic*], which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law.").

Unlike the situation with regard to the requirement of proof of reasonable reliance, the courts had long required proof of scienter under

B. Introduction Of A Proof of Reasonable Reliance Requirement Into Section 523(a)(2)(A) Would Be Contrary To The Legislative History Of The 1978 Bankruptcy Code

The legislative history of Section 523(a)(2) confirms that Congress did not intend to require proof of the reasonableness of reliance under subparagraph (A). Section 523(a)(2) is derived from Section 17(a)(2) of the Bankruptcy Act of 1898, former 11 U.S.C. 35(a)(2) (1976), which excepted from discharge debts that

> are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive.

When Congress adopted the 1978 Bankruptcy Code, it divided Section 17(a)(2) into two independent components, subparagraphs 523(a)(2)(A) and (B). As discussed above, subparagraph (A) addresses the general category of debts arising from fraudulent conduct "other than a statement respecting the debtor's or an insider's financial condition," 11 U.S.C. 523(a)(2)(A), while subparagraph (B) applies only to materially false, written statements of a debtor's, or insider's financial condition "on which the creditor to

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the predecessors to Section 523(a)(2)(A) and (B). See *Neal* v. *Clark*, 95 U.S. 704, 709 (1877) (construing Bankruptcy Act of 1867); *Carini* v. *Matera*, 592 F.2d 378, 381 (7th Cir. 1979) (construing Section 17(a)(2) of 1898 Act); *In re Houtman*, 568 F.2d 651, 655-656 (9th Cir. 1978) (same). Since the revision of the Code, the courts of appeals have uniformly required proof of scienter under subparagraph 523(a)(2)(A), see *In re Mayer*, 51 F.3d 670, 675 (7th Cir. 1995) (listing cases), and that question is not at issue in this case.

whom the debtor is liable * * * reasonably relied," 11 U.S.C. 523(a)(2)(B)(iii).

By introducing a proof of reasonable reliance requirement only as to the latter class of debts, Congress sought to address a specific problem. After extensive hearings,[6] Congress determined that the false financial statement language of Section 17(a)(2) of the Act had been frequently abused by consumer finance companies in a manner that frustrated the purposes of the Act. The House Report on the 1978 Code[7] describes the problem:

> It is a frequent practice for consumer finance companies to take a list from each loan applicant of other loans or debts that the applicant has outstanding. While the consumer finance companies use these statements in evaluating the credit risk, very often the statements are used as a basis for a false financial statement exception to discharge. The forms that the applicant fills out often have too little space for a

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[6] See H.R. Rep. No. 595, 95th Cong., 1st Sess. 2 & n.6 (1977) (discussing hearings before Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary); S. Rep. No. 989, 95th Cong., 2d Sess. 2 (1978) [hereinafter Senate Report] (discussing hearings before the Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary).

[7] In cases in which the text of a statute fails to provide clear guidance, this Court "ha[s] repeatedly stated that the authoritative source for finding the Legislature's intent lies in the Committee Reports on the bill, which 'represen[t] the considered and collective understanding of those [members of Congress] involved in drafting and studying proposed legislation.' " *Garcia* v. *United States*, 469 U.S. 70, 76 (1984) (quoting *Zuber* v. *Allen*, 396 U.S. 168, 186 (1969)). See also *Thornburg* v. *Gingles*, 478 U.S. 30, 43 n.7 (1986). Here, the Senate and House reports strongly reinforce the plain meaning of the statute's text. See *Kelly* v. *Robinson*, 479 U.S. 36, 50-51 (1986) (construing Section 523(a)(7) in light of House and Senate reports on the 1978 Code).

complete list of debts. Frequently, a loan applicant is instructed by a loan officer to list only a few or only the most important of his debts. Then, at the bottom of the form, the phrase "I have no other debts" is either printed on the form, or the applicant is instructed to write the phrase in his own handwriting. In addition, the form states that the creditor has relied on the statement in granting the loan.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 130 (1977) (footnote omitted) [hereinafter House Report]. The House Report further states that, although finance companies generally have available other methods of verifying the accuracy of a debtor's statement, these creditors had successfully used debtors' "deficient" statements to prevent the discharge of their underlying obligations when the debtors later filed for bankruptcy. *Id.* at 131.

The addition of a requirement that reasonable reliance be proved for obligations arising from false statements of financial condition was a direct congressional response to this practice. Based on the conclusion that "current law * * * requires only reliance, not reasonable reliance, by the creditor on the statement," House Report 130,[8] the House

[8] The House Report notes that "[t]he courts have recently begun to require that the reliance be reasonable," House Report 130, and elsewhere describes the addition of a reasonableness requirement as one that "codifies case law construing [Section 17(a)(2)]," *id.* at 364. In fact, there was considerable disagreement among the lower courts on this issue at the time of the Code's enactment. Compare *In re Arden*, 75 B.R. 707, 711 (Bankr. D.R.I. 1975) (inferring reasonableness requirement under Section 17(a)(2)) and *Sweet* v. *Ritter Finance Co.*, 263 F. Supp. 540, 542-543 (W.D. Va. 1967) (same) with *In re Houtman*, 568 F.2d at 655 (requiring only reliance) and *In re McGrath*, 7 B.R. 496, 498 (S.D.N.Y. 1980) (same); see also *In re Garman*, 643 F.2d 1252, 1256 (7th Cir. 1980) (interpreting pre-Code decisions employing the word "reasonable" as requiring only actual reliance). In any event, Congress clearly concluded that any judicial trend toward a proof of reasonable reliance requirement in financial statement cases was not so well-established as to obviate the need for express inclusion of the requirement in Section 523(a)(2)(B) of the new Code.

bill, and ultimately the final legislation,[9] included a proof of reasonable reliance requirement in the newly enacted Section 523(a)(2)(B) in order to prevent commercial finance creditors from taking unfair advantage of consumers seeking loans. House Report 130.

The false financial statement provision attracted considerable attention in the legislative process that proceeded the adoption of the Code. Citing the familiar problem of misuse by finance companies, the Commission on the Bankruptcy Laws of the United States[10] recommended that the false financial statement exemption be eliminated entirely for consumer debts. See H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. 1, at 176 (1973) ("On balance, the abuses and the harmful effects [of the false financial statement provision] far outweigh the benefit to creditors by this exception."). Other commentators, including the National Conference of Bankruptcy Judges, opposed the elimination of the false financial statement exemption, contending that such a change would unnecessarily "legislat[e] out of existence various substantive legal rights" of creditors. *The Bankruptcy Reform Act: Hearings Before the Subcomm. on Improvements in*

[9] The final House bill, H.R. 8200, 95th Cong., 2d Sess., was adopted by the Senate, in lieu of the parallel Senate version, S. 2266, 95th Cong., 2d Sess. 124 Cong. Rec. 28,284 (1978).

[10] Congress created the Commission on the Bankruptcy Laws of the United States in 1970 to "study, analyze, evaluate, and recommend changes to the [Bankruptcy] Act." S.J. Res. 88, 91st Cong., 2d Sess. § 1(b), 84 Stat. 468 (1970). The Commission filed its final report with Congress in July, 1973. H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. 1 (1973).

Judicial Machinery of the Senate Comm. on the Judiciary, 94th Cong., 1st Sess. Pt. 1, at 62 (1975). See also *id.* at 187, 202, 207. Ultimately, Congress struck a balance between these competing concerns by retaining the false financial statement exception but limiting its reach by the addition of a requirement of proof of reasonable reliance on the false financial statement. See, *e.g.*, House Report 131 (The 1978 Code "retains the exception, with small modifications. But it also recognizes that the leverage creditors have over their debtors comes not so much at the stage when the loan application is made, but rather when bankruptcy ensues."). Section 523(a)(2)(B) is the product of that compromise.[11]

As the legislative background described above demonstrates, Congress's separate treatment of the false financial statement provision was quite deliberate. See, *e.g.*, 124 Cong. Rec. 33,998 (1978) (statement of Sen.

[11] The division and alteration of Section 17(a)(2) of the old Act into Section 523(a)(2)(A) and (B) of the Code was one of several changes aimed at addressing creditor abuse of the "false financial statement" provision. At the same time, Congress also created Section 523(d) of the Code, which provides:

> If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. 523(d). The House Report explains that "[t]he purpose of the provision is to discourage creditors from initiating false financial statement exception to discharge actions in the hopes of obtaining a settlement from an honest debtor anxious to save attorney's fees. Such practices impair the debtor's fresh start." House Report 365. See also Senate Report 80 (using substantially similar language).

DeConcini) ("Subparagraph (A) is mutually exclusive from subparagraph (B). Subparagraph (B) pertains to the so-called false financial statement."). Indeed, if Congress had intended the reasonable reliance requirement to be applied to all debts arising from fraudulent conduct, there would have been no need to subdivide Section 17(a)(2) of the Act into subparagraphs 523(a)(2)(A) and (B); the more logical course would have been simply to include the reasonable reliance language in a unified Section 523(a)(2). By giving the same meaning to two provisions so carefully distinguished during the legislative process, the interpretation adopted by the court of appeals ignores the balance intentionally and explicitly struck by Congress.

C. Introduction Of A Reasonable Reliance Requirement Into Section 523(a)(2)(A) Would Contravene The Policy Judgments That Underlie The Bankruptcy Code

The courts that have required proof of reasonable reliance have primarily relied on the Code's general goal of providing debtors a "fresh start," concluding that that goal outweighs the interests of creditors who cannot prove that they acted reasonably. See, *e.g.*, *In re Phillips*, 804 F.2d 930, 932 (6th Cir. 1986); *In re Newmark*, 20 B.R. 842, 861-862 (Bankr. E.D.N.Y. 1982); *In re Brewood*, 15 B.R. 211, 215 (Bankr. D. Kan. 1981); cf. *In re Burgess*, 955 F.2d at 137 ("the statutory requirements for a discharge in bankruptcy are construed liberally in favor of the debtor") (internal quotation marks omitted). As this Court has instructed, however, the bankruptcy laws' "fresh start" principle "provides little assistance in construing a section expressly designed to make some debts non-dischargeable." *United States* v. *Sotelo*, 436 U.S. 268, 280 (1978) (construing Section 17(a)(1) of the Bankruptcy Act). The statutory language and legislative history discussed above demonstrate that Congress placed the interests of fraud victims above those

of dishonest debtors in the treatment of claims arising under Section 523(a)(2)(A).

"There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction." *Kelly* v. *Robinson*, 479 U.S. 36, 49 (1986) (quoting *Bank of Marin* v. *England*, 385 U.S. 99, 103 (1966)). Accordingly, this Court has frequently indicated that the Code's "fresh start" principle has far less importance when the obligation at issue arises from a debtor's dishonest conduct. See, *e.g.*, *Kelly* v. *Robinson*, *supra* (finding restitution, as a criminal penalty for welfare fraud, to be non-dischargeable under Section 523(a)(7)); *Grogan* v. *Garner*, 498 U.S. 279 (1991) (rejecting application of "clear and convincing evidence" standard in claims arising under Section 523(a)(2)); *Brown* v. *Felsen*, 442 U.S. 127 (1979) (res judicata did not bar creditor from demonstrating fraudulent conduct under Section 17(a)(2) in order to prevent discharge of a prior settlement agreement).

In *Grogan*, the Court considered the standard of proof that should be applied to objections to discharge brought under Section 523(a)(2). The court of appeals in that case had required that creditors prove their claims of fraud under Section 523(a)(2) by clear and convincing evidence. 498 U.S. at 282. There, as in the instant case, the court of appeals based its decision in part on its conclusion "that the general 'fresh start' policy that undergirds the Bankruptcy Code militated in favor of a broad construction favorable to the debtor." *Id.* at 283. This Court reversed, holding that a "preponderance of the evidence" standard best accommodated the interests at issue in claims brought under Section 523(a)(2). While acknowledging the Code's general policy of affording debtors a "fresh start," the Court recognized that

> [t]he statutory provisions governing nondischargeability reflect a congressional decision to exclude from the general policy of discharge certain categories of debts—such as child support, alimony, and certain unpaid educational loans and taxes, as well as liabilities for fraud. Congress evidently concluded that the creditors' interest in recovering full payment of debts in these categories outweighed the debtors' interest in a complete fresh start. We think it unlikely that Congress, in fashioning the standard of proof that governs the applicability of these provisions, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud.

498 U.S. at 287.

The same considerations counsel rejection of a reasonable reliance requirement under Section 523 (a)(2)(A). The burden facing a defrauded creditor is already substantial. The creditor must discover the fraud and affirmatively object to discharge in a timely fashion. See *Kelly* v. *Robinson*, 479 U.S. at 42 n.4. It is the creditor, moreover, who bears the burden of persuasion as to each element of Section 523(a)(2)(A) before the bankruptcy court. Bankr. R. 4005; see generally *Grogan* v. *Garner*, *supra*. Even where a creditor has reduced to judgment a state or federal fraud claim, it may still be required to relitigate that claim in bankruptcy court, to the extent that the elements of the underlying claim differ from the provisions of Section 523. See *Kelly* v. *Robinson*, 479 U.S. at 48 n.8. The Court should not increase a defrauded creditor's burden without a clear direction to do so from Congress.

D. Imposition Of A Reasonable Reliance Requirement On Creditors Proceeding Under Section 523 (a)(2)(A) Cannot Be Justified By Common Law Principles Of Fraud

Some of the courts that require proof of reasonable reliance have purported to rely on common law fraud principles. See, *e.g.*, *In re Hagedorn*, 25 B.R. 666, 669 (Bankr. S.D. Ohio 1982); *In re Paolino*, 89 B.R. 453, 462 (Bankr. E.D. Pa. 1988); see also *In re Kirsh*, 973 F.2d 1454, 1458-1459 (9th Cir. 1992) (finding reasonableness to be component of reliance inquiry); but see *In re Mayer*, 51 F.3d at 675-676 (rejecting reasonableness requirement based on, *inter alia*, common law tort principles). The reasoning of those decisions is flawed. The powerful textual and historical indicia of congressional purpose discussed above make the resort to state common law traditions inappropriate in this case. "[T]he issue of nondischargeability [is] a matter of federal law governed by the terms of the Bankruptcy Code." *Grogan* v. *Garner*, 498 U.S. at 284. See also *Astoria Fed. Savings & Loan Ass'n* v. *Solomino*, 501 U.S. 104, 110 (1991) (common law principles are to be "accorded sway only upon legislative default, applying where Congress has failed expressly or impliedly to evince any intention on the issue")

The common law principles of tort prevailing at the time of the Code's enactment, moreover, did not impose on victims of fraud the duty of investigation required of petitioners in this case (Pet. App. 30). See 3 Restatement (Second) of Torts § 540, at 88 (1977) (" The recipient of a fraudulent misrepresentation of fact is justified in relying on its truth, although he might have ascertained the falsity of the representation had he made an investigation."); William L. Prosser, *The Law of Torts* 718 (4th ed. 1971) (fraudulent assertions "may justifiably be relied on without investigation, not only where such an investigation would be burdensome or difficult, * * * but likewise where the falsity of the representation might be discovered with little effort by means easily at hand"). Even under common law principles, therefore, the courts below placed too great a burden on creditors victimized by fraud.

CONCLUSION

The judgment of the court of appeals should be vacated and the case remanded for further proceedings consistent with this Court's decision.

Respectfully submitted.

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JUNE 1995

(3)

No. 94-967

In The
Supreme Court of the United States
October Term, 1994

WILLIAM FIELD AND NORINNE FIELD,
Petitioners,
vs.

PHILIP W. MANS,
Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

JOINT APPENDIX

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**Petition For Certiorari Filed November 22, 1994,
Certiorari Granted May 1, 1995**

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U.S. District Court
U. S. District Court of New Hampshire (Concord)

CIVIL DOCKET FOR CASE #: 93-CV-401

In re: Mans — Filed: 07/23/93
Assigned to: Senior Judge Martin F. Loughlin
Demand: $0,000 — Nature of Suit: 422
Lead Docket: None — Jurisdiction: Federal Question
Dkt # in USBC-NH : is 91-1194
Dkt # in USBC-NH : is 90-12385
Cause: 28:1334 Bankruptcy Appeal

WILLIAM FIELD appellant	David H. Ferber, Esq. [term 08/17/93] [COR LD NTC] Laboe & Beasley PO Box 463 Concord, NH 03302-0463 225-5010 Christopher J. Seufert, Esq. [COR LD NTC] Seufert Professional Association 59 Central Street Franklin, NH 03235-1423 934-9837
NORINNE FIELD appellant	David H. Ferber, Esq. [term 08/17/93] (See above) [COR LD NTC] Christopher J. Seufert, Esq. (See above) [COR LD NTC]

v.

PHILIP W. MANS
appellee

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[term 08/06/93]
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Newport, NH 03773
863-1252

Philip W. Mans
[COR LD NTC] [PRO SE]
29 Slayton Hill Road
Lebanon, NH 03766

7/23/93	1	BANKRUPTCY RECORD on appeal received (bc) [Entry date 07/26/93]
7/26/93	2	NOTICE of docketing and briefing deadline; Bankruptcy briefing order deadline 9/14/93 (signed by Clerk James R. Starr) (bc)
8/9/93	3	ORDER, deft shall cause counsel to file and appearance by 9/7/93 or notify this court that he wishes to proceed pro se setting Notice of Compliance deadline to 9/7/93 (signed by Magistrate Judge William H. Barry Jr) (kats)
8/10/93	4	Appellant's BRIEF by William Field, Norinne Field. (kats) [Entry date 08/11/93]
8/13/93	5	MOTION by William Field, Norinne Field for David H. Ferber, Esq. to Withdraw as Attorney (pltfs represented by C. Seufert) (prk) [Entry date 08/16/93]
8/17/93	–	ENDORSED ORDER granting [5-1] motion for David H. Ferber, Esq. to

		Withdraw as Attorney (Terminated attorney David H. Ferber for Norinne Field, attorney David H. Ferber for William Field (signed by Senior Judge Martin F. Loughlin) (kats)
10/28/93	6	ORDER, deft/appellee, Mans has failed to file an appearance or responsive pleading, per this court's order, by 9/7/93; Accordingly this case is ready for the presiding judge to rule on the appeal on the basis of the record before the court (signed by Magistrate Judge William H. Barry Jr.) (kap) [Entry date 10/29/93] [Edit date 11/30/93]
10/29/93	–	file to MFL for ruling (kap)
11/29/93	7	MOTION by Philip W. Mans for Reconsideration of [6-1] order with memorandum; Objection to Motion Deadline 12/20/93 (kap) [Entry date 11/30/93]
12/7/93	8	ORDER denying [1-1] bankruptcy appeal; the bankruptcy court's ruling is affirmed because reasonable reliance is a required element to find non-dischargeable debt pursuant to 11 USC 523 (a)(2)(A) and because the record supports the finding that the appellants' reliance on the appellee's misrepresentations was not reasonable. (signed by Senior Judge Martin F. Loughlin) (kap) [Entry date 12/09/93]
1/12/94	9	ORDER the court hereby considers Philip W. Mans' letter of 8/26/93 as a pro se appearance and the order of 10/28/93 is abrogated (signed by Senior

		Judge Martin F. Loughlin) (kap) [Entry date 01/13/94]
1/27/94	10	JUDGMENT is hereby entered in accordance with Senior Judge Martin F. Loughlin's order dated December 7, 1993. (Signed by Clerk James R. Starr) (kap)
1/27/94	–	Case closed (kap)
2/7/94	11	MOTION by William Field, Norinne Field for Reconsideration of [10-1] judgment order with memorandum; Objection to Motion Deadline 2/28/94 (kap) [Entry date 02/08/94]
2/15/94	12	OBJECTION by Philip W. Mans to [11-1] motion for Reconsideration of [10-1] judgment order (kap) [Entry date 02/16/94]
3/22/94	13	ORDER denying [11-1] motion for Reconsideration of [10-1] judgment order (signed by Senior Judge Martin F. Loughlin) (kap)
4/13/94	14	NOTICE OF APPEAL by William Field, Norinne Field. Fee Status: -$0- Appeal Record Transmittal Due 4/19/94 File stamped copies to all parties with Appeal Information Sheet; certified copy of docket, entire original case file, appeal information sheet to CCA. (jeb) [Entry date 04/15/94]
4/13/94	15	Addendum by appellant William Field, appellant Norinne Field to [14-1] appeal (jeb) [Entry date 04/15/94]
4/13/94	16	DESIGNATION by William Field, Norinne Field of record on appeal RE: [14-1]

		appeal by Norinne Field, William Field. Entire original record to be forwarded on appeal. (jeb) [Entry date 04/15/94]
4/15/94	–	Appeal record sent to CCA with Clerk's certificate on [14-1] appeal by Norinne Field, William Field – transmitting documents: 1-16 (jeb)
4/15/94	–	Called Attorney Suefert's Office – no filing fee included with notice of appeal. They said it would be mailed out this date to USDC-NH. (jeb)
4/20/94	–	Filing Fee Paid; FILING FEE of $105.00 re PLAINTIFF'S NOTICE OF APPEAL – RECEIPT # 005952. Called CCA on 4/21/94 and advised them. Send Earline at CCA a copy of the receipt. (jeb) [Entry date 04/21/94]
4/26/94	–	USCA Case Number Re: [14-1] appeal by Norinne Field, William Field USCA NUMBER: 94-1391 (kap)
8/31/94	165	OPINION of CCA Re: [14-1] appeal by Norinne Field, William Field (kap) [Entry date 10/05/94]
9/22/94	17	MANDATE OF CCA Re: [14-1] appeal by Norinne Field, William Field. Upon consideration whereof, it is now here ordered, adjudged and decreed as follows: The judgment of the district court is affirmed. (jeb)
9/23/94	–	Record on appeal returned from U.S. Court of Appeals: [14-1] appeal by Norinne Field, William Field (jeb)
5/16/95	–	Certiorari was granted on May 1, 1995. U.S. Supreme Court has requested

immediate transmittal of entire district court record to their court. Pursuant to their request, document nos. 1-17 forwarded to Sandy Nelsen, Assistant Clerk-Merits, U.S. Supreme Court, this date. (jeb) [Edit date 05/16/95]

The Judgment, dated 8/29/94 of the United States Court of Appeals for the First Circuit is reproduced at pg. 14 of the Petitioners' Petition for Writ of Certiorari.

The Order, dated 8/29/94, of the United States Court of Appeals for the First Circuit is reproduced at pgs. 15 through 16 of the Petitioners' Petition for Writ of Certiorari.

The Order, dated 3/22/94, of the United States District Court for the District of New Hampshire is reproduced at pgs. 17 through 21 of the Petitioners' Petition for Writ of Certiorari.

The Judgment, dated 1/27/94 of the United States District Court for the District of New Hampshire is reproduced at pg. 22 of the Petitioners' Petition for Writ of Certiorari.

The Order, dated 12/7/93 of the United States District Court for the District of New Hampshire is reproduced at pgs. 23 through 31 of the Petitioners' Petition for Writ of Certiorari.

Final Judgment, dated 5/11/93 of the United States Bankruptcy Court for the District of New Hampshire is reproduced at pg. 32 of the Petitioners' Petition for Writ of Certiorari.

[p. 12] WILLIAM FIELD – Cross/Mans

* * *

A. In the original agreements? Not that I know of.

Q. Did I agree to do all of the other things that you asked: pay your attorney's fees, pay the interest, and make my payments directly to the bank?

A. In the letter, you agreed to pay my attorney fees for the transaction, but you disagreed that you would give me any excess money.

Q. I –

A. – and I assumed the issue was dead when you didn't meet the terms.

Q. I did not agree to give you the $10,000 fee?

A. Say that again, Phil.

Q. I did not agree to pay you a $10,000 additional fee, is that correct?

A. No, you did not; although, I would have incurred additional costs to research your new buyer and everything.

Q. Was that information transmitted to you by my attorney by letter of October 27th?

A. That you would not go forward with the transaction, yes.

Q. Did you have a conversation with a business associate of yours by the name of Sal?

A. Sal Lucido.

Q. Yes.

A. Yes. He was my boss.

Q. Did you say – did he tell you that he was on your [p. 13] property and he met Mr. De Felice there?

A. Yes, he did.

Q. Did he tell you that Mr. De Felice told you that he owned the property? He was the owner of the property.

A. Yes, he did.

Q. What was the time period of that, Mr. Field?

A. Mr. Lucido is my boss. He said he was up on the property with a new person he was training and he met someone there and they said that they were the new owner, this Mr. De Felice. I said that is crazy, he couldn't sell it without my permission, and I left it go at that. I think I spoke with you, if you want me to volunteer any other things. Maybe a month later or so when you were late on a payment and you said, "Don't worry about it. It's just something we're doing, and he's helping me on the property."

Q. Was this time period –

A. And I left it go at that.

Q. – in 19– late 1987, early 1988?

A. I'm not sure of the date of that conversation with Sal. It would have been I think in '88 sometime when he was training one of the new men up in that territory that I moved out of.

Q. So you did in 1988 know that the property had been transferred?

A. Absolutely not. As I'll repeat to you, my answer. My [p. 14] boss told me that someone said he was the owner. I didn't believe it was possible because I had paper from you, Phil, and I called and asked you and you said, "No, don't worry about it. I'm just handling it some other way." And I left it go that you got so many businesses, Phil, I don't who – partners you're taking for what –

Q. Did I –

A. – or what involvement DeFelice might have in it.

THE COURT: Excuse me a moment. Excuse me a moment. It was changed, was it?

THE CLERK: It was changed on the notice and Dory never changed it.

THE COURT: All right. We will interrupt this a moment. There was a scheduling mix up. The cash collateral that was scheduled at four o'clock was actually rescheduled to the 9:30. The people want to continue that. Is that correct?

(Off the record. Back on the record)

BY MR. MANS:

Q. Mr. Field, didn't the letter of October 9th, 1987, to your lawyer –

THE COURT: Just a moment.

MR. MANS: I'm sorry, Your Honor. (Pause).

THE COURT: Okay. Back on Mans. Back on that.

MR. MANS: Thank you, Your Honor.

THE COURT: Proceed.

* * *

[p. 20] know that they had done something different, then it would keep me pacified not looking further.

Q. Yes. But that's totally irrelevant to me because when make them.

A. I appreciated that, sir, every month.

Q. What other reasons they might have is pure speculation.

A. That's exactly true, sir.

THE COURT: Proceed.

BY MR. MANS:

Q. Mr. Field, did you not state in your deposition that you spoke with Mr. Bennett at Mascoma Savings Bank on at least two occasions in 1987 and 1988?

A. I spoke with Mr. Bennett after we tried to get some kind of an agreement with you in reference to a direct transfer so that we wouldn't be calling for late payments, and I spoke with Mr. Bennett after Mr. Lucido mentioned this other person that said they were the owner, and he comforted me.

THE CLERK: How are you spelling Lucido.

THE WITNESS: L-U-C-I-D-O.

THE CLERK: Thank you.

BY THE WITNESS:

A. And I asked him if he knew of anything because we're out of the area, and he said he knew absolutely of no changes whatsoever, so I again let it go down the drain. I just [p. 21] figured it was rumor.

Q. Wasn't this, in fact, after – wasn't this, in fact after the transfer and you discussed Mr. De Felice and Crescent Beach Development with Mr. Bennett at the bank?

A. After what transfer?

Q. After the transfer that you alleged that you did not know of.

A. I didn't know of any transfer, sir. It was after Mr. Lucido told me that there was someone there that said he was an owner. It was after that I asked, yes.

Q. Didn't you also say in your deposition that you had talked to Mr. De Felice and his attorney during this period of time?

A. No, sir. Not whatsoever. None whatsoever. None.

Q. After I had filed bankruptcy in December of 1990 personally –

A. Okay.

Q. – and this – the corporation that held the stock that you sold me for the Crescent Beach property was anticipating filing bankruptcy, did I not tell you that I would try to work with Mr. De Felice to try and get him

to buy out my interest so that you would – so you would get some money from him?

A. Yes.

Q. Okay. Did – in fact, you said in your deposition, "I had a conversation with Mr. Mans in 1991 or 1992 on how I [p. 22] could get cleaned out and De Felice could still hold onto the property." Does that sound correct to you?

A. That they were going to pay me off, yes.

Q. And you said that Mans was trying to get me some money out of De Felice?

A. Nance said he was working with you. I don't know what arrangement you two fellows had, but to my knowledge, Phil, you were working with him to pay me off.

Q. At the same time that you were discussing the same sort of payoff with him?

A. Yes. I was accepting – going to accept money at that point. This in '91.

Q. Did he not, in fact, offer you $125,000 for your interest of the note that was worth approximately $145,000 at that point?

A. Yes, sir. He offered a hundred and twenty-five and then he called from his attorney's office and said the attorney decided not to do it.

Q. Is it fair to say that the reason that he did not finally go through with it is he started at 110 – $100,000, and 110, and he just felt it would never stop and –

MR. SEUFERT: Objection. I'm not sure that my client knows what some other third party might have said or thought.

MR. MANS: Your Honor, he had – he was mean with [p. 23] him on an ongoing basis.

THE COURT: You can't refer to what the – somebody else may say they did or didn't do. You can ask this fellow whether he was offered different amounts and whether it was negotiated.

BY MR. MANS:

Q. Were you offered different amounts? Were you offered $100,000? $110,000? $125,000 from Mr. De Felice in an ongoing negotiation process?

A. On the phone, yes.

Q. Okay.

BY THE COURT:

Q. Did you accept the 125,000?

A. Yes sir. I had agreed to accept and release the interest I had in that at that time, yes, sir, at 125,000, and then the next morning, Mr. De Felice backed off of it and said his lawyer told him not to do it, that he was involved with Mr. Mans on other things. I don't know what happened, but it fell through, sir.

BY MR. MANS:

Q. Did I not encourage you to take his offers?

A. Yes, Phil. But again he backed off from making that offer.

Q. Be backed off from the $125,000 offer?

A. He made no counter offer after that agreement. His

* * *

W. FIELD – Direct Testimony To The Court

[p. 26] Q. It wasn't being developed or it was being developed?

A. It was being destroyed, but I thought it was in its process of being developed, and it would never get there. At one or two times, I would speak to Mr. Mans. He said he was being held up by different processes, but his intentions were going forward.

Q. Did you ever see Mr. De Felice at the property when you went there?

A. No, sir.

Q. Was there anybody there when you went there?

A. No, sir. We could just see it from the outside and we never went inside the building, sir. I didn't think that was my prerogative.

Q. Did you ever talk to Mr. Mans about what's going on, is anything happening?

A. Yes. He showed me some beautiful pictures on blueprints and designs. This was, oh, two years into this, I would say, that he had planned to put a boardwalk down and make it a Victorian hotel and do all of the things that we had dreamed all the years we owned it and we didn't have the money to do it, so though it was in a mess, I thought that was getting worse before it gets

better. I had no idea of the other things that were happening at that time.

Q. Now sometime in 1988, your boss told you that he had seen Mr. De Felice there?

[p. 27] A. Yes.

Q. And that De Felice said he was the new owner?

A. De Felice was on our beach and there was trucks or so there.

Q. Did De Felice refer to himself as the new owner?

A. Yes. "I'm one of the new owners," or so he said. But, Your Honor, he has a number of businesses, and one of the times is I took in partners and I didn't know that he would physically sell my property. I thought it – he had two or three properties all around there that he had purchased, and if he had taken on somebody for more money to add more area for the community or what have you, I wouldn't know what he was doing. But when I spoke with Mr. Mans, I had no indication from him that he had sold my property and transferred that. Whether he took on another partner with Sequoia (phonetic) or some other outfit was not concern. If he's getting money from trailer parks or what was not – whoever his partners were. I never dreamed that he had taken the property that he legally couldn't transfer and transfer it. It just didn't occur to me he would do that, sir.

MR. MANS: Your Honor, would you like to see some of the drawings I showed Mr. Field?

THE COURT: No thanks.

* * *

PHILIP W. MANS – Direct/Seufert

[p. 30] Yes.

Q. As part of the purchase price, you gave him back a promissory note in the amount of $187,500?

A. Yes. I gave him $275,000 in cash and a promissory note of $187,000.

Q. The promissory note was secured by a second mortgage on the property?

A. Yes.

Q. You are aware that those Mortgages had a clause in there that any transfer or retransfer of that property needed the written consent of Mr. Field?

A. Yes.

Q. You're familiar with that clause?

A. Yes.

THE COURT: Is that in evidence?

MR. SEUFERT: Yes, it is, Your Honor. You will look at Exhibits N and O.

BY THE WITNESS:

A. Your Honor, may I step down and get a copy of that from my desk?

THE COURT: Yes. You can have your own copies. What paragraph?

MR. SEUFERT: It will be the last paragraph, I believe, on both exhibits, Your Honor.

THE COURT: This is a typical due-on-sale clause.

[p. 31] It doesn't prevent transfer. It simply provides that if you transfer it without the consent, the debt becomes due.

MR. SEUFERT: That's correct, Your Honor.

THE COURT: But there's nothing to prevent the party from transferring it.

MR. SEUFERT: That's correct, Your Honor.

THE COURT: All right. Go ahead.

BY MR. SEUFERT:

Q. Now when you consummated this transaction in June of 1987, you also gave the Fieldses a personal financial statement, did you not?

A. Yes.

Q. Okay. Sir, do you have a copy of that financial statement that you gave to Mr. Field at the transaction?

A. No, I don't.

MR. SEUFERT: Okay. Your Honor, could we move to – all those exhibits into evidence so that we don't have to go back.

THE COURT: These were premarked and agreed beforehand by both sides.

MR. SEUFERT: Yes, Your Honor.

THE COURT: Both set? All right. They'll all be marked into evidence. Mark them all off.

THE CLERK: Plaintiff's Exhibits 1 through 16 entered as evidence.

* * *

W. FIELD – Direct Testimony To The Court

[p. 49] A. Yes, sir.

Q. Do you understand that?

A. Yes, sir.

Q. Now it's curious to me that with the letters in October, you did absolutely nothing to check the state of the title to see if maybe it was transferred. When your boss tells you that Mr. De Felice is going around claiming to be the owner, it would take about a half hour to check the title to see what – whether it was transferred.

A. But I did not believe that it was transferred.

Q. And you didn't believe that because of these letters?

A. I thought that he refused to do it, and I thought that number one, this was, oh, six months or more later that this De Felice thing even came into that picture, and I thought that maybe he had got involved in the project and bought some other property or put money in to be involved with Mans. I didn't think that he really would transfer the property after being – asking and telling no. Your Honor, I took his money and bought my annuity from the Knights of Columbus myself. I would have taken any surplus money and put it – because I didn't need the money while I was still working with Knight that he was paying me each month. I would take that and invest it, so that when I retired I'd have money. You see

what I'm saying. So had I known that he had broken that contract – not broken the contract, sold the place – I now [p. 50] have the option of getting that money in bulk by foreclosing or something like that, calling the note or whatever they say. I had no knowledge that he had done that. I never suspected he could do it without being notified. I thought I had a registered mortgage and if anything had happened, they'd have to notify me that the property was transferred.

Q. Well, you had an attorney, right? The attorney responded to Mr. Man's letter or his attorney's letter?

A. Yes, sir.

Q. Did you ever discuss with your attorney what could be done?

A. I don't recall discussing it after the letter came back that said he wasn't going to do the deal and meet our agreements. I thought the issue was dead then.

Q. He said he would do the deal. He would meet your – all your requirements except the $10,000 item?

A. Yeah. That he would just pay my lawyer's fee or something.

Q. You did not respond to that letter?

A. No, sir. He wouldn't pay it. I thought it was dead.

Q. That was a counter offer. You made no response to his counter offer?

A. Not to my knowledge, sir, except that we thought that it was –

Q. He said he would do everything you requested. He

* * *

WILLIAM FIELD – Redirect/Seufert

[p. 53] money in equal – in a lump, as you say with that capital. I would have gotten it over the period and preferably that way because it would have lasted the rest of my life as a retirement money rather than just this ten-year block.

Q. Okay.

THE COURT: I have no other questions.

REDIRECT EXAMINATION

BY MR. SEUFERT:

Q. I have one last question, Mr. Field. In '88 when your boss had told you that there was some other gentleman on the property, you testified earlier that you confronted Mr. Mans about that and he denied it?

A. I don't remember that confrontation. If I had said it occurred then it must have. I spoke with Mr. Mans in reference to late payments.

Q. Okay.

A. I spoke with Mr. Mans in reference to the way the building was being completely destroyed type of a thing. He showed me plans that he had of what was being done, so I left it go at that. I don't recall the question again was what?

Q. Did you ask him if, in fact, he had sold the property?

A. No. I don't believe I ever confronted because first, I never really thought that that could happen without my mortgage being released. Perhaps, I was stupid in that –

Q. Okay.

* * *

[p. 67] THE COURT: You sent the letter on October 19th saying that you'd agree to their terms except for the ten thousand?

MR. MANS: Yes, Your Honor.

THE COURT: And then the 19th was the day the deed was actually recorded?

MR. MANS: Yes. We said that we would do that – we'd meet three of the terms, but we wouldn't meet that fee that we didn't feel was reasonable and fair. And we felt that the due on sale clause was at best a breach of contract that he had the option to call the note if he wanted to and he didn't. I continued to make payments for three years after that on time and –

THE COURT: Let's take these one by one. The first element is misrepresentation, and I don't see how you get out of misrepresentation. Those letters would imply to a lawyer, let alone a layman, that you hadn't yet transferred it and you're asking his consent.

MR. MANS: All I can say, Your Honor, is I didn't feel that when I signed the deed – I've signed a lot of deeds ahead of time in a lawyer's office and we put them in a folder and then gone to the closing two or three days later because of time schedules, not being able to get

together, and that the closing actually took place on the 12th and the recording was on the 19th, so I considered that in my mind that the [p. 68] closing actually took place when the deed was recorded on the 19th.

THE COURT: Well, that doesn't get you off the hook anyway because the second letter went out on the 19th.

MR. MANS: Yeah. On the 19th, again, conversations orally saying –

THE COURT: Saying that if you would agree to everything except the ten thousand to get your consent to a conveyance.

MR. MANS: We wouldn't agree to the conveyance, so we were going ahead without their consent on the 19th.

THE COURT: All right. I'm going to find that there was a misrepresentation by you and your attorney in sending letters to Mr. Field that clearly implied that it had not yet been transferred, which I don't see how you could read the letters any other way – I think that a minimum full disclosure would have said, "We have a deal with De Felice. He wants to put some money in this thing; would you consent"? Had you done that, Mr. – well, you did tell him that –

MR. MANS: The letter does say that, Your Honor.

THE COURT: That's right. It says that you would – you have some investor that wanted to put some money in the property, and –

MR. MANS: It said we had a deal with Crescent Beach development.

[p. 69] THE COURT: I don't know that you mentioned De Felice, but you mentioned an investor.

MR. MANS: It says,

"Phil has brought in another substantial investor and formed a development partnership called Crescent Beach development. They will be investing a huge sum of money into the development of the property and thereby further enhance the security for the second mortgage held by Mr. and Mrs. Field." So we –

THE COURT: Well –

MR. MANS: – did tell them.

THE COURT: You may have thought that you wouldn't have any trouble getting the consent, but the fact remains that the letter does not disclose a material fact that was in place at the time and that was that you had already drawn a deed to this fellow.

MR. MANS: I couldn't imagine, Your Honor, that –

THE COURT: And you didn't disclose that because you didn't wanted to trigger the due on sale clause.

MR. MANS: I couldn't imagine that bringing in an investor who was going to invest over $625,000, take half of the responsibility for the $350,000 note and give me $447,500 in cash to develop the property of which we each put in another $50,000 immediately for development

cost, wouldn't [p. 70] enhance the value of the property and improve the Fields' position. The fact that the real estate went down later –

THE COURT: Of course, it would, but if you had disclosed those numbers, the obvious result would be that they would say, aha, you got a lot of cash, we'd rather get cashed out. Why don't you cash us out?

MR. MANS: Because Mr. Field told me all along that wasn't what he wanted. He kept telling me that this was part of a retirement. The fact that the – there was a clause in the agreement saying that it could not be prepaid and that if I prepaid it, I would have to pay all of the prepaid interest and the fact that he told me that he did not want the tax ramifications, he had discussed it with his accountant.

THE COURT: That's not evidence. I'm just dealing with – you did say something to that effect, but he – from the balance of testimony here, I would find that there was no real reason why he'd not want to have the money put into an annuity. That testimony just – you didn't bring that out with him in any detail that I can make findings of. The fact that – anyway on misrepresentation, I will find that that element was established. That is, of course, not the entire case. The rest is whether they relied and whether they relied to their detriment and whether their reliance was reasonable. As far as whether Mr. Field relied, there's no question he did rely. He simply didn't check the title. Whether that was [p. 71] reasonable or not is probably the key issue here. The detriment seems established also unless you have some comment on that. If –

MR. MANS: I would comment –

THE COURT: – if you had told them that it's transferred, at that point he could have cashed himself out. You had the liquid money to do so?

MR. MANS: Not at the time that I filed bankruptcy, Your Honor.

THE COURT: No. I'm talking about October of '87.

MR. MANS: Yes, I did. But he didn't want –

THE COURT: The market was better and the cash was there.

MR. MANS: I did, but he didn't want that. That – I wanted to do a straight deal where I paid the whole thing in cash because I didn't want Mr. Field to be holding a second mortgage. You know, in the protracted negotiations I had with him, I knew that he would be around as he was constantly, be looking in – over my shoulder, and a lot of the things that he said that he wanted done with the property that I – that he imputed to me, when I looked at the property, the property was not of any value as far as the building. We brought architects and engineers in, and they said the building has to be torn down.

MR. SEUFERT: Objection. Your Honor, is this [p. 72] evidence or is this closing because these are facts not in evidence, Your Honor?

THE COURT: Mr. Mans is not a lawyer, and he's in effect testifying. I will exclude from my consideration any additional facts. I know what was testified to, and I'll only rely on that. But in terms of whether Mr.

Field relied, not whether it's reasonable, he – it seems to me there's no contrary evidence here that he relied on these letters as implying that, well, if we didn't agree on the deal, you hadn't transferred the property. And in terms of whether it was reliance to his detriment, again, it seems to me that it clearly was to his detriment because he could have either foreclosed at that point and got it out of a good market or he could have in effect forced you to pay it up out of some monies that came out of the transaction.

MR. MANS: As far as detriment, Your Honor, when I filed bankruptcy in 1990, I met with him and I met with De Felice to try and put together a deal because De Felice wanted the property. I raised that testimony here today, Your Honor, and De Felice would have paid him a hundred or $110,000, but he balked at the $125,000.

THE COURT: Well, that's less than what he was owed, so that's detriment. There's no – this record is crystal clear that he could have been cashed out in October of '87.

MR. MANS: Yes, sir.

[p. 73] THE COURT: That's a dead issue.

MR. MANS: Yes, sir.

THE COURT: The only issue left is whether this reliance was reasonable in the circumstances, and I think that's probably going to decide this case. He says that because of the letters he didn't do what he could have done which was simply check the record, and that you in effect deflected him from doing that by the letters because after the letters, he figured, well, we didn't agree

on anything so you weren't transferring it. What's your response?

MR. MANS: My response was that all of the things that were going on indicated – the letter was very clear. The initial letter that we sent on October 9th, we had an agreement with a partner coming in. We had put together a contract for a development company. He was bringing in a lot of money and that we wanted their doing – their permission under the due on sale clause, but if they didn't – if we didn't get their permission, there were other ways to go, and we were negotiating those other ways, and it was clear to me that we would have agreed to all the items except the $10,000 fee which I thought was unreasonable and unfair, and I had no – absolutely no thought that Mr. Field would not agree to the transfer given all of the benefits that surrounded the property, particularly at that time of the year and the economy when things were booming and that was a valuable piece [p. 74] of property. Even at the foreclosure sale in 1991, the bank got the full amount of their first mortgage in a heartbeat. At that time he could have come in and bid and the buyer probably would have gone a lot higher because the bank got covered first bid.

THE COURT: Well, he could have done that if he could have got financing for a bid at that time. How do you get any real estate financing – when, in 1991? When was this foreclosure sale?

MR. MANS: 1991, Your Honor.

THE COURT: Yeah. Unless you happened to have some ready cash, not too many people were buying

at foreclosure sales except for the FDIC with paper because you couldn't get a loan from the bank.

MR. MANS: The Mascoma Bank was very solvent, and I had – I don't know Mr. Field's personal financial situation, but I know that they were very – very positive on the property, and they gave the buyer who came to auction financing for it, so I would assume that they would have given it to Mr. Field, too. They had also offered it to Mr. De Felice.

THE COURT: All right. Any other comments?

MR. MANS: No, sir.

THE COURT: No response?

MR. SEUFERT: None.

[p. 75] THE COURT: Let's see the rest of those exhibits. I don't –

THE CLERK: Do you want them all?

THE COURT: Pardon me?

THE CLERK: Do you want them all?

THE COURT: Yes, all of them. Okay. We'll take a recess until twelve and then we'll announce the ruling, about 15 minutes. (Off the record at 11:47. Session resumed at 12:08)

THE COURT: The Court has before it for trial the matter of Field v. Mans, in *In re: Mans,* case number 90-2385, adversary 91-194. This matter has been tried this morning with testimony and documents with regard to a 523(a)(2)(a) charge that the debt owing to the plaintiffs is

nondischargeable as having been obtained by fraud and false pretenses. Actually, the way the evidence has come down is in terms of obtaining an extension of that credit by fraud or false pretenses at a time when the plaintiffs' allege that they were misled into not pursuing their rights under a due on sale clause by misrepresentations given the – given to them by the defendant implying at least that no transfer had occurred.

To back up a moment, the transaction in question was commenced by an agreement for sale of Mascoma Lodge property on Mascoma Lake near Enfield, New Hampshire, in 1986 which was consummated by a closing and documentation in June of 1997, [p. 76] whereby a promissory note and second mortgage was granted by the buyer to the seller, the plaintiffs here, for a balance of approximately $187,000 of the purchase price. They were paid $275,000 in cash at that time. The mortgage deed – actually there were two deeds, but it's immaterial that there were, in fact, two for – one from Sequoia and one then from Mascoma Lodge Enterprises, Inc., both controlled by Mr. Mans. Each of these documents has a – what is commonly referred to as a due on sale clause which provides that the mortgagor, that is the defendant here, covenants and agrees that it will not convey an interest in or title to the property mortgage without prior written consent of the mortgagee, and if they should so convey without consent of the mortgagee, quote:

> "The whole of the unpaid balance of the indebtedness on this mortgage and the promissory note secured here by me at the option of the holder of this mortgage become immediately

due and payable without further notice," unquote.

The record establishes that on October 8th, 1987, the defendant here caused Mascoma Lake Lodge Enterprises, the then title holder, to transfer the property to Crescent Beach Development, a New Hampshire general partnership. The deed was executed on that date, but was not recorded until October 19, 1987.

On October 9, 1987, the defendant through his [p. 77] attorney corresponded with the attorney for the Fields indicating that the defendant was proceeding with the development of the Mascoma Lake property and that the debtor had brought in a substantial investor and formed a development partnership called Crescent Beach Development whereby the investor would be investing, quote, "A huge amount of money in the development of the property," unquote, which would further enhance the security for the second mortgage held by Mr. and Mrs. Field.

The October 9th letter states that obviously the defendant here did not want to trigger the due on sale clause by reason of the transfer into the development partnership and asked that Mr. and Mrs. Field, as holders of the second mortgage, consent in writing to the transfer of the property to Crescent Beach Development. As indicated above, the deed to Crescent Beach had already been executed on October 8th but had not yet been recorded.

The letter refers to the fact that the defendant could have avoided the due on sale clause by putting the stock

of the corporation into the partnership rather than conveying title to the underlying real property but for various reasons it was preferable to convey the property. As the evidence has established, that was preferable because the new investor, a Mr. De Felice, required that the property be conveyed into the new partnership. He did not want to take the corporate stock [p. 78] of the title holder with the possibility of exposure for unpaid debts by that corporation.

The October 9th letter was answered by a letter dated October 19, 1997 – 1987 from the attorney for the Fields. It indicated the Fields would consent to the transfer upon receiving payment of $250 in lost interest due from the previous closing of this transaction; on condition that Philip Mans make all future mortgage payments by direct bank transfer; on condition that the Mans pay the Fields attorney's fees of approximately $250 to negotiate this consent; and quote, "A one time fee payable upon transfer of $10,000," unquote. The evidence before me indicates that there was no basis for the demand for the $10,000 other than as a condition that the Fields felt they could impose with some economic leverage since Mans was in a process of bringing a new investor in, in which he would have some additional funds into the project and apparently the Fields believed that they could extract another $10,000 even though the purchase price of the property had been negotiated previously in the prior June of the same year. Mr. Field testified that that money was necessary to investigate the new buyer, but I don't find that evidence has any weight since it's apparent to me that had the Fields been given their $10,000, they would

have consented to this transfer without any further investigation.

As indicated above, the deed was actually recorded [p. 79] on October 19, 1987, the date of this letter back from the Fields.

On October 27, 1987, the defendant through his attorney responded to the October 19th letter and indicated that the defendant would be willing to make all the payments requested in the October 19th letter and would be agreeable to having the mortgage payments made by direct transfer, but, quote, "However, the fee of $10,000 is out of the question," unquote.

There is no further correspondence between these parties in this record until February 6th of 1991 which was after the bankruptcy filing of – (Pause). Filing date of December 10, 1990. On that date –

On February 6th, 1991, the Fields' attorney wrote to them indicating that he did some research in the Grafton County Registry of Deeds and found various things including the fact that the Mans did – quote, "Mans did convey the property to Crescent Beach Development. This would trigger the first and second mortgages to the point that the entire amount can be called forward at present," closed quote.

The testimony before this Court establishes in my judgment that the letters from the defendant to the plaintiff in October of 1987 did contain an implicit misrepresentation, i.e., that the property had not yet been transferred and that it would be transferred upon the consent of the Fields in [p. 80] accordance with the

request of the – Mr. Mans. The letters, in my judgment, do imply that no transfer had yet occurred and that would be the normal reaction of any party receiving that letter, whether an attorney or otherwise. The letters do no [sic] imply or that the debtor would not transfer without the consent if he wished to face the due on sale trigger clause. I don't find that the misrepresentation – that it was represented impliedly, that if they couldn't [sic] a deal for the consent that Mans would not – nevertheless, transfer the property and face the due on sale trigger if the Fields agreed – elected to assert that. In other words, the representation that's implicit in those letters is that we haven't yet transferred the property and we need your – want your consent to do so. When the request for consent fell through by – because of the $10,000 demand by the Fields, it's an open question as to whether there was any continuing representation by the debtor that he would not transfer the property.

The evidence clearly establishes that the Fields relied on the implicit representation in these letters that the property had not yet been transferred. It's also established that they relied on this representation and their belief that it had not been transferred and would not be transferred to their detriment in that – at the time of October 1987, the real estate market was still booming in this state and they could have extracted their balance of 187,000, [p. 81] approximately, out of either a foreclosure or forcing Mans to pay out of the funds that he was getting invested in the property or otherwise. As it turned out, the real estate market in the late '80s went into a profound slump and the market values that existed

then were dissipated to the point where when the property was finally foreclosed in 1991, the first mortgagee, in effect, wiped the Fields' position. But to the extent that the reliance and detriment elements are required here, it's obvious to me that they in their own minds did rely on these representations subjectively and didn't do anything further and that in effect they extended the credit to Mr. Mans for another few years, whereby – whereas they could have called the due on sale clause as of October 1987 at the latest when the deed was recorded.

The issue then boils down to the question of reasonable reliance. It is not sufficient in this – under this statute in the Bankruptcy Code to show a misrepresentation and reliance to detriment, but the reliance must be shown to be reasonable in the circumstances.

In that regard, the evidence is that in 1988 – or first that the Fields – at least Mr. Fields visited the property on numerous occasions to see whether – and what kind of development Mr. Mans was doing, and that on one occasion his boss told him that he – the boss had been on the property and had seen a Mr. De Felice who had stated that, quote, "I am [p. 82] the new owner," unquote. The evidence also indicates that Mr. Field discussed this with the banker that held the first mortgage on the property and didn't get any information but demonstrates that he knew that De Felice was claiming to be the owner on the property. Mr. Field apparently in his own mind believed that the property could not have been transferred without his consent which of course as a matter of law is not true. It clearly could be transferred without his consent, but the only result would be to trigger the due on sale clause. There is some conflicting testimony in this record that Mr.

Field did not want prepayment because he was looking for these payments to be part of his retirement. However, there's also testimony that he could have solved that problem by simply putting them into an annuity fund that he had if [sic] had called the loan and got the cash. On balance, I don't believe that it's been established that Mr. Field did not want prepayment in relevant time context of October 1987.

The evidence before me is uncontroverted that Mr. Field was around quite a bit looking at the drawings and the project and talking with Mans as to the progress in developing the property and was accepting mortgage payments for some forty-two months which were paid on currently throughout this transaction until a month or so before Mr. Mans filed his – the month before he filed his bankruptcy case in December 1990. There is also evidence that following the bankruptcy [p. 83] Mr. Field was negotiating with De Felice for a payoff of the second mortgage and had negotiated the number up to $125,000 when the mortgage debt was approximately 150,000, and in fact had accepted that amount from De Felice, but then De Felice backed out of that offer to pay it – obtain that debt at a discounted amount.

Considering all of the foregoing facts, what appears to me most relevant on the reasonable reliance requirement is that the – there's no statement in the letters that could be read as saying we will never transfer the property without your consent. What there was in those letters was a request to transfer – a request to get consent to transfer the property to avoid the due on sale clause. That series of letters and correspondence broke down basically

because of the $10,000 demand by the Fields as a condition for their consent. That left the situation unstructured. In effect, as I said, above – I don't think those letters can be read to imply that Mans would not elect to transfer without the consent and face the due on sale clause if the Fields elected to assert it. Mans in his own mind apparently believed they wouldn't assert it because they wanted a stream of a payments. Whether he was correct or not, he had that option and could have run that risk. Likewise, the Fields, when the situation broke down, had an easy way to determine what Mans was or wasn't doing by simply doing one of two things. They could have number one, [p. 84] asked him what the deal was De Felice who was there, obviously, on the premises acting like an owner. Field never did that over three-and-a-half years of accepting mortgage payments and looking at drawings and discussing the project with Mans. Number two, they could have simply checked the title in the Grafton town – the County Registry of Deeds which Mr. Field has demonstrated he knows very well is up in North Haverhill. That wasn't done either. My judgment is that what really happened here was that the deal as requested broke down because of the demand for the 10,000 and that the market was strong and Mans was paying and it's to some extent hindsight to now say, well, if we'd know [sic] then we would have called the loan. Nobody knew in October 1987 that the market was going to take a nose-dive. And the conduct of the Fields in not taking easily available steps to find out whether the – after the requested consent broke down to see what Mans, in fact, was doing with De Felice out there is explainable either in terms of their not thinking about –

or not understanding what Mans' options were or simply the fact that they weren't that concerned about triggering the due on sale clause even if [sic] were transferred. I know that it probably appears now that they would have done it. We all think in hindsight. When I think of all those properties I should have bought, when I think of all those classic automobiles that I should have bought back twenty or thirty years ago, and I remember [p. 85] now that I would have done it, but back in 1957 when I could have bought a Chevrolet Impala convertible for $2,700, which is now worth $35,000, and instead bought a DKW which is now worth zero and was within a few years worth zero, what I don't remember is that I didn't have the extra $400 to buy that convertible, but I know from human nature that when I think about it, I forget those facts.

In this case, I think there is a lot [sic] hindsight here as to how serious this appeared to the Fields at the time and whether they would have triggered the due on sale clause. That to me is the only explanation for their failure to take those easily available steps of simply asking either De Felice or Mans, what's the deal here? Who owns this thing? Has there been a transfer, or checking the title in North Haverhill?

Even if I accept Mr. Field's testimony that he wasn't sophisticated in these affairs and that he assumed that Mr. Mans couldn't transfer the property without his consent, I would find that that is not reasonable reliance. A party is not entitled to, you know, be in good faith and just not objectively reasonable. It's not just the subjective test. It's – the case law establishes an objective test, and that is what would be reasonable for a prudent man to do

under those circumstances. At a minimum, a prudent man, I think, would have asked his attorney, could he transfer it without my [p. 86] consent? And the answer would have to be yes, and then the next question would be, well, let's see if he's done it? And those questions simply were not asked, and I don't think on balance that was reasonable reliance.

For all these reason [sic], with regard to these findings I will rule that the plaintiff has failed to establish one of the requisite elements for a nondischargeability under Section 523(a)(2)(A) and that the judgment therefore must be in favor of the defendant. The debt in question is nondischargeable.

I realize from the Fields' standpoint, they have suffered a substantial loss, and it must be a very hard to take that loss when they had the options at various stages looked at with hindsight of taking cash in October of '87. If they had triggered the due on sale clause, made the necessary inquiry and triggered it, and/or taken a hundred and twenty thousand or so in '91 when De Felice was apparently willing to pay a number around that amount, whereas now they end up with nothing, and if this property – if this debt is dischargeable, they in effect have suffered a severe loss. However, in bankruptcy by definition most of the creditors suffer a loss because of breach of contract or various nonperformances by the debtor, and it's only those breaches or debts that are obtained under conditions that make them nondischargeable that survive the bankruptcy and remain an obligation by the debtor. In making that determination, this Court cannot look with [p. 87] hindsight as to what happened after the transaction in question. I have to look

at it as it existed in October of '87, and as I say, in reviewing all these facts, it's my judgment that in October of '87 there was not reasonable reliance on any representations by Mr. Mans once the deal contemplated by those series of letters had fallen through. It is my opinion that the Fields had an obligation at that point to make one of several easily available inquires to ascertain the status of that title and decide whether they wanted to trigger the due on sale clause. So ordered. I thank you for your attention and appropriate judgment will be entered incorporating by reference my findings and conclusions. So ordered.

(Court was then adjourned at 12:44 p.m.)

* * *

EXHIBIT B

BROWNELL & MOESER

A Professional Corporation

Attorneys and Counsellors at Law

[Letterhead Omitted For Printing]

October 9, 1987

Christopher Seufert, Esq.
Five Summer Street
Concord, NH 03301

RE: William Field/Phil Mans

Dear Chris:

As I indicated to you on the telephone, we are proceeding with the development of the Mascoma Lake Property, including the two parcels owned by Mascoma Lake Lodge Enterprises, Inc., the stock of which is wholly owned by Sequoia Security Investment Corp., Phil Mans Corporation. As you know, there is a second mortgage to Mr. & Mrs. Field secured by this property which contains a "due on sale" clause.

Phil has brought in another substantial investor and formed a development partnership called Crescent Beach Development. They will be investing a huge amount of money in the development of the property and thereby further enhance the security for the second mortgage held by Mr. & Mrs. Field.

Obviously we do not want to trigger the "due on sale" clause by reason of the transfer of the property into the development partnership. We ask that Mr. & Mrs. Field,

as the holders of the second Mortgage, consent in writing to the transfer of the property from Mascoma Lake Lodge Enterprises, Inc. to Crescent Beach Development.

We would appreciate your earliest response to this. We could avoid the issue entirely by simply putting the stock of Mascoma Lake Lodge Enterprises, Inc. into the partnership instead of conveying title to the underlying real property, but for a variety of reasons it is preferable to convey the property.

Thank you for your assistance

Sincerely,

BROWNELL & MOESER

By: /s/ Gary
Gary T. Brooks

GTB/ks

EXHIBIT C

Seufert & Thompson, P.C.

Attorneys-at-Law

5 Summer Street

Concord, NH 03301

(603) 224-8672

[Letterhead Omitted In Printing]

October 19, 1987

Gary T. Brooks, Esquire
Brownell & Moeser
P.O. Box 200
Norwich, VT 05055

RE: William Field/Phil Mans

Dear Gary:

The Fields will consent to the proposed transfer upon the following conditions:

1. Payment of $250.00 in lost interest due from the previous closing.

2. Phil Mans to make all future mortgage payments by direct bank transfer.

3. Payment of their attorney's fees of approximately $250.00 to negotiate this matter.

4. One time fee, payable upon transfer, of $10,000.00.

Very truly yours,

/s/ Christopher J. Seufert
Christopher J. Seufert, Esquire

JS:cmd

EXHIBIT D

BROWNELL & MOESER

A Professional Corporation

Attorneys and Counsellors at Law

[Letterhead Omitted For Printing]

October 27, 1987

Christopher J. Seufert, Esq.
Seufert & Thompson, P.C.
5 Summer Street
Concord, NH 03301

RE: William Field/Phil Mans

Dear Chris:

This is in response to your letter of October 19, 1987, with the benefit of consultation with my client who has just returned from several trips.

My client would be willing to make the payments referred to in paragraph 1 and paragraph 3 of your letter, and would be agreeable to having future mortgage payments made by direct bank transfer. However, the fee of $10,000.00 is out of the question.

Sincerely,

BROWNELL & MOESER

By: /s/ Gary
Gary T. Brooks

GTB/ks
cc: Philip W. Mans

EXHIBIT M

PROMISSORY NOTE

U.S. $187,500.00 LEBANON, NEW HAMPSHIRE
JUNE 23, 1987

FOR VALUE RECEIVED, the undersigned promises to pay William D. Field, and Norrine T. Field of Enfield, New Hampshire, or Order, the principal sum of One Hundred Eighty-Seven Thousand Five Hundred Dollars ($187,500.00) with interest on the unpaid principal balance from the date of this Note, until paid, at the rate of Ten Percent per Annum (10%). The principal and interest shall be payable to the Holder by payment to Enfield, New Hampshire, or such other place as the Holders of this Note may designate in writing. The principal and interest shall be payable in one hundred twenty equal monthly installments of Two Thousand Four Hundred Seventy-Seven and 84/100 ($2,477.84) Dollars each of principal, plus accrued interest on the unpaid balance, on the 23rd of the month.

The undersigned shall pay to the Holder hereof a late charge of five percent (5%) of any, installment not received by the Holder hereof within ten (10) days after the installment is due.

If any installment under this Note is not paid when due and remains unpaid for thirty days, the entire principal amount outstanding under this Note and interest thereon shall at once become due and payable at the option of the Holder of this Note; failure to exercise this

option shall not constitute a waiver of the right to exercise this option if the undersigned is in default under this Note.

The principal sum secured by this Note shall also become due and payable at the option of the Holder of this Note on the happening of any default or event by which, under the terms of the mortgage securing this Note, the principal sum may or shall become due and payable, and all covenants, conditions, and agreements contained in the mortgage securing this Note are, by this reference, made a part of this Note.

The undersigned shall not have the right to prepay, in whole or in part, the principal amount outstanding under this Note.

In the event of any default in the payment of this Note, and if suit is brought on this Note, the Holder of this Note shall be entitled to collect in such proceeding all reasonable costs and expenses of suit, including, but not limited to, reasonable attorney's fees. In addition thereto, the Holder shall be entitled to assess and collect upon foreclosure all interest that would have been paid through the full ten (10) year term of this Note.

The undersigned at its sole option, may elect at any time during the term of this Note to substitute a fully paid annuity in exchange for the satisfaction and cancellation of this Note, provided that said annuity unconditionally guarantees payment to the Holder of the same amounts as would otherwise be due under this Note.

Presentment, notice of dishonor, and protect are hereby waived by all makers, sureties, guarantors, and

endorsers of this Note. This Note shall be binding on the maker and his heirs, personal representatives, successors and assigns.

The indebtedness evidenced by this Note is secured by a second mortgage on real property in the Town of Enfield, New Hampshire, subject only to a first mortgage to Mascoma Savings Bank or any subsequent "rollover" of such first mortgage (but only to said bank) in a principal amount never to exceed to a total of $350,000.00.

SEQUOIA SECURITY INVESTMENT CORP.

/s/ Christopher J. Seufert
Witness

By: /s/ Philip W. Mans L.S.
President and
duly authorized

PERSONAL GUARANTY

The undersigned hereby unconditionally guarantees the payment and performance of Sequoia Security Investment Corp. of the foregoing Promissory Note, including without limitation payment over ten (10) years of principal and interest.

/s/ Christopher J. Seufert
Witness

/s/ Philip W. Mans
Philip W. Mans,
individually

EXHIBIT N

SECOND MORTGAGE DEED

With Power of Sale

Mascoma Lake Lodge Enterprises Inc., a/k/a MLL ENTERPRISES, INC. a duly established corporation under the laws of New Hampshire having a principal place of business at Mascoma Lake, Fuller Road, Enfield, County of Grafton, State of New Hampshire, for consideration paid, grants to William D. Field and Norrine T. Field, Mortgagee, as JOINT TENANTS with RIGHTS OF SURVIVORSHIP, whose mailing address is Pembroke Street, Pembroke, County of Murrimack, State of New Hampshire, with MORTGAGE COVENANTS, to secure the payment of One Hundred Eighty-Seven Thousand Five Hundred Dollars ($187,500.00). In accordance with the terms of a note of even or nearly even date herewith and payable to the said Mortgagee, or order, or any renewals or partial renewals thereof, according to the tenor and effect thereof, the following described property:

> All and the same land and premises as conveyed to the Mortgagor herein by Warranty Deed of even date from the Mortgagee herein, to be recorded in the Grafton County Registry of Deeds prior to the recording of this Mortgage, and being further described as follows:
>
> Two certain tracts or parcels of land on both sides of Fuller Road in Enfield, County of Grafton and State of New Hampshire, being all and the same lands and premises as conveyed to the Mortgagor herein by Warranty Deed of even

or nearly even dated herewith to be recorded just prior to the recording of this Mortgage.

Being all and the same land and premises as conveyed to William D. Field by Warranty Deed dated June 15, 1971, from Marcel R. Renault and Helen C. Renault and R. Lawlor Cooper and Marcel R. Renault and R. Lawlor Cooper d/b/a Crescent Beach Motor Inn, recorded in the Grafton County Registry of Deeds at Book 1143, Page 256.

This is a Second Mortgage and is subject only to a First Mortgage of even date herewith from the Mortgagor to Mascoma Savings Bank for $350,000.00, such first mortgage to be recorded in the Grafton County Registry of Deeds just prior to the recording of this Second Mortgage. The first mortgage may be rolled over with Mascoma Savings Bank beyond the original ninety (90) day period without violating the terms of this paragraph.

This mortgage is upon the STATUTORY CONDITIONS, for any breach of which the Mortgagee shall have the STATUTORY POWER OF SALE.

Advertising of any foreclosure notice shall be in some newspaper of general circulation of Enfield, New Hampshire. The proceeds of any such sale shall be charged with the expenses thereof, including reasonable attorney's fees.

Mortgagor, in accordance with RSA 477:29 II shall not commit or suffer any strip or waste on the mortgaged premises. If mortgagor wishes to alter the existing buildings on said mortgaged properties he shall first cause an appraisal to be completed which established the value of the mortgaged property. If said appraisal established that

the value of the property less the buildings as exists is less than the combined outstanding balance of principal and interest on the first mortgage, if still existing, and the second mortgage secured by this instrument, then prior to commencement of any alterations mortgagor must provide a performance bond payable to mortgagee for any present outstanding balance of principal and interest on this second mortgage. Such performance bond must continue until the value of the mortgaged property again meets or exceeds the combined outstanding balances on the first and second mortgages.

The Mortgagor covenants and agrees that it will not convey an interest in or title to the premises hereby mortgaged or assign this instrument without prior written consent of the Mortgagee. It is further agreed, as a condition of this mortgage in the event that an interest in or title to this property is transferred or this instrument is assigned without the consent of the mortgagee first obtained in writing, the whole of the unpaid balance of the indebtedness on this mortgage and the promissory note and/or any renewal or renewals thereof and/or any optional readvances and interest thereon, secured hereby, may, at the option of the Holder of this mortgage, become immediately due and payable without further notice. Failure of the Mortgagee to institute collection procedures immediately upon knowledge of a breach of this condition shall not constitute a waiver of the Mortgagee's right to subsequent collection action.

IN WITNESS WHEREOF, I hereunto set my hand and seal this 6th day of July 1987.

MASCOMA LAKE LODGE ENTERPRISES INC.
(a/k/a MLL ENTERPRISES, INC.)

/s/ Gary T. Brooks
Witness

By: /s/ Philip W. Mans L.S.
President and duly authorized

STATE OF NEW HAMPSHIRE
GRAFTON COUNTY, SS.

At Lebanon this 6th day of June, 1987. Philip W. Mans personally appeared and he acknowledged this instrument, by him sealed and subscribed to be his free act and deed and the free act and deed of Mascoma Lake Lodge Enterprises Inc. (a/k/a MLL ENTERPRISES, INC.)

Before me:

/s/ Nancy A. Conrad
Notary Public/Justice of Peace
My Commission expires 9-25-96
(Seal)

Received and recorded: July 8, 1987 12:30 P.M.

/s/ Carol A. Elliott, Register

(4)

No. 94-967

In The

Supreme Court of the United States

October Term, 1994

WILLIAM FIELD AND NORINNE FIELD,

Petitioners,

vs.

PHILIP W. MANS,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

PETITIONERS' BRIEF

Christopher J. Seufert
(Counsel of Record)
William J. Schultz
Seufert Professional Association
59 Central Street
Franklin, New Hampshire 03235
(603) 934-9837
Counsel for Petitioners

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

30pp

QUESTION PRESENTED FOR REVIEW

Given that 11 U.S.C. § 523(a)(2)(A) requires proof that creditors rely on a debtor's fraudulent actions in order that a debt be excepted from discharge in Bankruptcy under 11 U.S.C. § 523(a)(2)(A), and given that the Bankruptcy Court has found fraud, and reliance by the creditor upon the debtor's misrepresentation, is it also necessary that the creditor prove that its reliance upon the fraudulent misrepresentation was reasonable?

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CITATIONS TO OPINIONS AND JUDGMENTS BELOW

United States Bankruptcy Court for the District of New Hampshire BK #90-12385 Chapter 7 Adv. #91-1194 Judgment #46 Book 4 unpublished opinion, final judgment dated May 11, 1993.

United States District Court for the District of New Hampshire C-93-41-L, unpublished order dated December 7, 1993.

Civil Action #1:93-CV-0041-L, United States District Court for the District of New Hampshire judgment dated January 27, 1993, on order of December 7, 1993.

United States District Court for the District of New Hampshire, C-93-401-L, order dated March 22, 1994.

United States Court of Appeals for the First Circuit 94-1391 unpublished opinion dated August 29, 1994.

GROUNDS ON WHICH JURISDICTION OF THE UNITED STATES SUPREME COURT IS INVOKED

This is an appeal of the judgment entered August 29, 1994 by the United States Court of Appeals for the First Circuit, affirming the judgment of the United States District Court for the District of New Hampshire dated December 7, 1993, affirming the decision of the United States Bankruptcy Court dated May 11, 1993, finding the debt of the defendant to the plaintiffs to be dischargeable in Bankruptcy.

Certiorari was sought in accordance with 28 U.S.C. § 1254(1) and United States Supreme Court Rules Rule

10.1(a) and 10.1(c), by petition filed November 22, 1994. The deadline set by the Court for filing the Petition for Writ of Certiorari, in accordance with United States Supreme Court Rule 13.1 was November 26, 1994.

Certiorari was granted May 1, 1995. The deadline set by this Court for filing of the Appellants' Brief in accordance with United States Supreme Court Rule 25 is June 15, 1995.

CONSTITUTIONAL AND STATUTORY PROVISIONS

UNITED STATES CONSTITUTION ARTICLE I, SECTION 8:

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

To borrow Money on the credit of the United States;

To regulate Commerce with Foreign Nations, and among the several States, and with the Indian Tribes;

To establish an uniform Rule of Naturalization, and uniform Laws on the subject to Bankruptcies throughout the United States; . . .

28 U.S.C. § 1254

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

(2) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

11 U.S.C.A. § 523(a)(2)(A) (West 1994)

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual from any debt –

> (2) for money, property, or services, or an extension, renewal, or refinancing or credit, to the extent obtained, by –
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; . . .

11 U.S.C.A. § 523(a)(2)(B) (West 1994)

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) or this title does not discharge an individual from any debt –

(2) for money, property, or services, or an extension, renewal, or refinancing of credit, to the extent obtained, by –

(B) use of a statement in writing –

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied;

(iv) that the debtor caused to be made or published with intent to deceive; . . .

UNITED STATES SUPREME COURT RULES:

RULE 10 Considerations Governing Review on Writ of Certiorari

.1 A review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only when there are special and important reasons therefor. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons that will be considered:

(a) When a United States court of appeals has rendered a decision in conflict with the decision of another United States court of appeals on the same matter; or has decided a federal question in a way in conflict with a state court of last resort; or has so far departed from the accepted and usual course of judicial proceedings, or

sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision.

. . .

(c) When a state court or a United States court of appeals has decided an important question of federal law which has not been, but should be, settled by this court, or has decided a federal question in a way that conflicts with applicable decisions of this Court.

. . .

STATEMENT OF THE CASE

In June, 1987 the plaintiffs, William and Norinne Field (Fields) sold real estate to an entity wholly owned by the defendant, Philip Mans (Mans), were paid approximately $275,000.00 cash and were given a promissory note in the amount of $187,500.00. The note was guaranteed by Mans, and was secured by a second mortgage on the property which was duly recorded at the Registry of Deeds. (The mortgage was junior to a mortgage to Mascoma Savings Bank.) (CP. 24).[1] The mortgage prohibited the defendant from conveying the property without the prior written consent of the plaintiffs, and further stated

[1] Throughout this document, citation format will be as follows: (CP ___) refers to petitioners' petition for Writ of Certiorari, and appendix thereto. (A ___) refers to the joint appendix to this brief. (R ___) refers to the transcript of the trial, May 11, 1993, 9:57 a.m. before Judge James E. Yacos, United States Bankruptcy Court for the District of New Hampshire.

that, on such a sale, the whole of the remaining indebtedness secured by the mortgage would, at the option of the holder of the mortgage, be immediately due and payable. (R.76). On or about October 8, 1987, in direct violation of these terms of the mortgage, Mans caused a transfer of title of the mortgaged property to a partnership known as Crescent Beach Development ("Crescent Beach"). (R.76).

The transfer, pursuant to the terms of the mortgage, triggered the due-on-sale clause, but the plaintiffs were unaware that the transfer had taken place. In fact, Mans had intentionally concealed the transfer in such a way as to defraud the plaintiffs, by sending a letter purportedly seeking permission for the transfer, AFTER the transfer was nearly complete. (R.77). Specifically, the letter, dated October 8, 1987, advised the Fields that Mans had taken on a partner in the development of the property. The letter further went on to say:

> Obviously we do not want to trigger the "due-on-sale" clause by reason of the transfer of the property into the development partnership. We ask that Mr. and Mrs. Field, as the holders of the second mortgage, consent in writing to the transfer of the property. (R.77).

The Fields responded by letter dated October 19, 1987. Among other conditions, they stated that they would approve the transfer if they received a payment of $10,000.00. (R.78). Mans, through counsel, responded on October 27, 1987 that "the fee of $10,000.00 is out of the question." However, Mans in this October 27, 1987 correspondence did not disclose to the Fields that the transfer had actually already taken place despite the lack of consent. (R.79).

The Fields, subsequent to the undisclosed transfer, continued to receive payments on the note through November, 1990. No further payments were forthcoming, and the Fields received notice of Mans' voluntary bankruptcy petition in December of 1990. The Mascoma Bank foreclosed on the property on or about June 7, 1991, recovering its first mortgage. No funds were available to satisfy the Fields' second mortgage. (R.81).

The Fields filed a non-dischargeability complaint against Mans in the Bankruptcy Court under the provisions of § 523(a)(2)(A) arguing that they were "duped" into extending credit (the promissory note) beyond its time period (option to call upon subsequent transfer) by Mans' fraud in obscuring the fact that he had transferred the property. Federal Court jurisdiction over this matter was grounded on Article I of the United States Constitution, and Title 11 of the United States Code. After trial, the Bankruptcy Court found that in fact an extension of credit was proven, that misrepresentations had taken place and that reliance was proven, but that the plaintiffs failed to prove that their reliance on the fraud was reasonable.

Since the Bankruptcy Court explicitly found that the debtor committed fraud, and that the creditor relied upon that fraud, and since those findings have been upheld by the United States District Court for the District of New Hampshire and the First Circuit Court of Appeals, the only issue on appeal to this Court is whether or not the creditors were required to prove, under § 523(a)(2)(A)

that their reliance upon the debtor's misrepresentations was reasonable.

SUMMARY OF THE ARGUMENT

The plain language of 11 U.S.C. § 523(a)(2)(A) does not require that a creditor's reliance on a debtor's fraud be reasonable. By contrast 11 U.S.C § 523(a)(2)(B) has such a requirement. The Congressional history explains why "reasonable reliance" is in the latter section but not the former; Congress was seeking to prevent creditors who might induce fraud from benefiting from their collusion in creating the fraud.

Nonetheless, a split has developed amongst the circuit courts of appeals on whether to include a requirement of reasonableness of reliance in § 523(a)(2)(A) cases. The more compelling argument is found in those decisions not requiring reasonableness of reliance. These decisions fairly balance an honest debtor's right to a fresh start, a core purpose of the Bankruptcy Code, with protecting creditors from the fraud of dishonest debtors.

The elements of common law fraud or misrepresentation contain sufficient safeguards to prevent creditors from relying on obviously false or absurd representations.

In the instant case while all the elements of non-dischargeability were found in the lower courts, those courts erroneously found the disputed debts dischargeable because they required proof of reasonable reliance.

ARGUMENT

I. THE PLAIN LANGUAGE OF 11 U.S.C. § 523(a)(2)(A) DOES NOT REQUIRE THAT A CREDITOR'S RELIANCE ON THE FRAUD OF A DEBTOR BE REASONABLE.

"When interpreting a statute, the starting point is, of course, the language of the statute itself. If the language is clear and unambiguous, and there is no clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive." *American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982) and *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

11 U.S.C. § 523(a)(2)(A) governs the dischargeability of the debt in the instant case. § 523(a)(2)(A) sets out the following elements of a non-dischargeability claim for fraud:

> 1. The debt must be for money, property, services, or an extension, renewal or refinancing of credit.
>
> 2. Obtained by false pretenses, a false representation, or actual fraud, **other than a statement respecting the debtor's or an insider's financial condition.** (emphasis added). (The full text of § 523(a)(2)(A) and § 523(a)(2)(B) is set out at petitioners' Petition for Writ of Certiorari, pages xi and xii.)

The language of § 523(a)(2)(A) is clear and unambiguous. There is no additional requirement that the creditor's reliance on the fraud be "reasonable". By contrast 11 U.S.C. § 523(a)(2)(B) specifically requires that creditors seeking non-dischargeability of debts under that section

prove their reliance was reasonable. Since the plain language of the statute excludes § 523(a)(2)(A) debts from § 523(a)(2)(B), by removing the class of debts created by a statement respecting a debtor's or insider's financial condition and creating § 523(a)(2)(B) to **only** include such debts, the element of reasonable reliance contained in § 523(a)(2)(B) applies only to non-dischargeability claims brought under that section.

Not only does the plain language of this statute exclude § 523(a)(2)(A) debts from § 523(a)(2)(B), but review of the Congressional history of these sections indicates that the sections were meant to be mutually exclusive.[2] Where the clear language of the statute and the Congressional intent are completely in harmony, the conclusion is that the reasonable reliance element applies only to claims of non-dischargeability brought under § 523(a)(2)(B). Because the debt in the instant case does not fall under § 523(a)(2)(B) but falls under § 523(a)(2)(A), the creditors' reliance on the fraud of the debtor need not be proven reasonable for the debt to be found non-dischargeable. "Finding the statute clear on its face and having no reason to think that Congress meant anything other than what it said, we can only conclude that § 523(a)(2)(A) does not require a creditor to prove that his

[2] 124 Cong. Rec. H 11,095-6 (Daily Ed. Sept. 28, 1978); S 17, 412-13 (Daily Ed. Oct. 6, 1978). "Subparagraph A is intended to codify current case law e.g. *Neal v. Clark*, 95 U.S. 704 (24 L.Ed. 586) (1887), which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law. Subparagraph A is mutually exclusive from subparagraph B. Subparagraph B pertains to the so-called false financial statement". 124 Cong. Rec. S 17412 (Daily Ed. Oct. 6, 1978) (remarks of Senator DeConcini).

reliance on the debtor's fraudulent misrepresentations was reasonable". *IN RE: Ophaug*, 827 F.2d 340 (8th Cir. 1987) at 343.

II. THE LEGISLATIVE HISTORY OF § 523(a)(2)(A) AND § 523(a)(2)(B) AND THEIR PREDECESSOR STATUTE SHOW NOT ONLY AN INTENT THAT THESE SECTIONS BE MUTUALLY EXCLUSIVE, BUT SHOW A SUBSTANTIVE REASON BEHIND APPLYING A HIGHER STANDARD OF RELIANCE IN § 523(a)(2)(B) CASES.

The predecessor statute to § 523(a)(2) is former 11 U.S.C. § 35(a)2. The language of the former statute did not contain a requirement that reliance upon the debtor's fraud be reasonable. *IN RE: Ophaug*, 827 F.2d 340 (8th Cir. 1987) at 342.[3]

The term reasonable reliance as applied to non-dischargeability first appears in the modification of the predecessor act in the Bankruptcy Reform Act of 1978, 95 Stat. 2549 (1978).

The legislative history of the modifications reflects not only an intent to make separate provision for written financial statements under § 523(a)(2)(B), but also makes clear the reasoning behind applying a separate standard of reliance from the types of debts whose dischargeability were governed by § 523(a)(2)(A). *Ophaug*, at 342, 343, *In*

[3] The case law under the former section likewise did not require reasonable reliance. *Id.*, citing *IN RE: Houtman*, 568 F.2d 651, 655 (9th Cir. 1978). However, the predecessor statute did not make separate provision for false or fraudulent written financial statements, as does the present version.

the Matter of Mayer, 1995 WL 193188 (7th Cir. Ill.). The concern was that creditors might induce debtors to falsify financial statements in order to make a debt non-dischargeable. Congress therefore explicitly required that non-dischargeability claims brought under § 523(a)(2)(B) be premised upon a showing of reasonable reliance by the creditor. *Ophaug,* at 342, 343, citing HR. Rep. No. 595, 95th Cong., 1st Sess. 130-31 (1977) U.S. Code Cong. and Administrative News 1978, P. 5787.[4] The amended section

[4] "Current law provides a nearly identical exception to discharge. The differences are that current law does not cover a debt for services, and requires only reliance, not reasonable reliance, by the creditor on the statement. . . . The premise of the exception to discharge is that a creditor that extended credit based on misinformation or fraudulent information transmitted by the debtor should be protected. The provision, however, has led to abuse in consumer cases, and has frustrated the fresh start goal of the bankruptcy discharge.

It is a frequent practice for consumer finance companies to take a list from each loan applicant of other loans or debts that the applicant has outstanding. While the consumer finance companies use these statements in evaluating the credit risk, very often the statements are used as a basis for a false financial statement exception to discharge. The forms that the applicant fills out often have too little space for a complete list of debts. Frequently, a loan applicant is instructed by a loan officer to list only a few or only the most important of his debts. Then, at the bottom of the form, the phrase "I have no other debts" is either printed on the form, or the applicant is instructed to write the phrase in his own handwriting. In addition, the form states that the creditor has relied on the statement in granting the loan.

thus prevented creditors from essentially participating in the fraudulent act of the debtor (by closing their eyes to fraud at the time the debt is created) by discharging those debts upon which the creditor's reliance was not reasonable, while allowing those honest creditors who make sufficient inquiry (whose reliance is reasonable) to prevent discharge of the debts owed them. *Id.* See also *IN RE: Fosco,* 14 B.R. 918 (1981) at 918. "The requirement of reasonable reliance under § 523(a)(2)(B) makes abusive practices of this type less likely to succeed." *Id.*

However, the creditor often has other sources of information, such as credit bureau reports, to verify the accuracy of the list of debts. Nevertheless, if the debtor files bankruptcy, creditors with these financial statements are in a position to threaten the debtor with litigation to determine the dischargeability of the debt, based on the false financial statement exception to discharge. Most often, there has been no intent to deceive on the part of the debtor, and, as in so many aspects of the creditor-debtor relationship, the debtor has simply followed the creditor's instructions with little understanding of the consequences of his action.

Creditor practices in this area have been so strong that the Bankruptcy Commission recommended that the false financial statement exception to discharge be eliminated for consumer debts. This bill recognizes, however, that there are actual instances of consumer fraud, and that creditors should be protected from fraudulent debtors. It retains the exception, with small modifications. But it also recognizes that the leverage creditors have over their debts comes not so much at the stage when the loan application is made, but rather when bankruptcy ensues." *HOUSE REPORT 595, 95TH CONGRESS, 1ST SESSION, PGS. 130-131.*

Subsequent to the changes contained in the 1978 Act, some courts began to require reliance to be "reasonable" in non-dischargeability claims brought under § 523(a)(2)(A) as well as those brought under § 523(a)(2)(B), despite the clear language of the statute.[5]

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See 97 ALR Fed. 402 for analysis.

Circuit Courts of Appeals:

IN RE: Burgess, 955 F.2d 134 (1st Cir. 1992)
Philips v. Coman, 804 F.2d 930 (6th Cir., 1986)
IN RE: Mullet, 817 F.2d 677 (10th Cir. Colo. 1987)
"Justifiable" rather than "reasonable" reliance required:
IN RE: Kursh, 973 F.2d 1454 (9th Cir. 1992)

District Courts:

IN RE: Hunt, 30 B.R. 425 (M.D. Tenn. 1983)
IN RE: McIntyre, 64 B.R. 27 (D.N.H. 1986)
IN RE: Michel, 74 B.R. 88 (N.D.Ohio 1985)
Title Ins. Corp. v. Pitt., 157 B.R. 585 (E.D. Va. 1991)

Bankruptcy Courts:

IN RE: Paolino, 89 B.R. 453 (B.C. E.D. Pa. 1988)
IN RE: Wise, 6 B.R. 867 (B.C. M.D. Fla. 1980) (discussing § 523(a)(2) in general)
IN RE: Ashley, 5 B.R. 262 (B.C. E.D. Tenn. 1980)
Bonosky v. Allen, 25 B.R. 566 (B.C. S.D. Ohio 1982)
IN RE: Constantino, 72 B.R. 231 (B.C. N.D. Ohio 1987) later proceeding 80 B.R. 865
IN RE: Cheh, 96 B.R. 781 (B.C. N.D. Ohio 1988)
IN RE: Cicero, 28 B.R. 480 (B.C. E.D. Wis. 1983)
IN RE: Guy, 101 B.R. 961 (B.C. N.D. Ind. 1988)
IN RE: Younesi, 34 B.R. 828 (B.C. C.D. Cal. 1983)
IN RE: Howarter, 95 B.R. 180 (B.C. S.D. Cal. 1989)
IN RE: Brewood, 15 B.R. 211 (B.C. D.C. Kan. 1981) (disapproved on other grounds by *Birmingham Trust Nat. Bank v. Case*, 755 F.2d 1474 (11th Cir. Ala. 1985))
IN RE: Maranzino, 67 B.R. 394 (B.C. D.C. Kan. 1986)
IN RE: Anzman, 73 B.R. 156 (B.C. D.C. Colo. 1986)
IN RE: Gering, 69 B.R. 686 (B.C. D.C. Kan. 1987)

Other courts, specifically the Eighth Circuit, Seventh Circuit and the Fifth Circuit, as well as other lower courts, do not require reasonable reliance.[6]

The analysis used by those courts requiring proof of reasonable reliance as an element in § 523(a)(2)(A) cases

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IN RE: Beleau, 35 B.R. 259 (B.C. D. R.I. 1983)
IN RE: Salvatore, 46 B.R. 247 (B.C. D. R.I. 1984)
Matter of Eaton, 41 B.R. 800 (B.C. E.D. Wis. 1984)
Matter of Weinstein, 31 B.R. 804 (B.C. E.D. N.Y. 1983)
IN RE: Gonzalez Seijo, 76 B.R. 11 (B.C. D. P.R. 1987)
IN RE: Waning, 120 B.R. 607 (B.C. D. Me. 1990)
IN RE: Sestito, 136 B.R. 602 (B.C. D. Mass. 1992)
Matter of Haining, 119 B.R. 460 (B.C. D. Del. 1990)
U.S. v. Spicer, 155 B.R. 795 (B.C. D.C. Dist. Col. 1993)
ITT Fin. Servs. v. Schoenlein, 157 B.R. 824 (B.C. N.D. Ohio 1993)
First Bank Sys., N.A. v. Foley, 156 B.R. 645 (B.C. D.C. N.D. 1993)

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Circuit Courts of Appeals:

IN RE: Ophaug, 827 F.2d 340 (8th Cir. 1987) 97 ALR Fed. 395
Matter of Allison, 960 F.2d 481 (5th Cir. 1992)
In the Matter of Mayer, 1995 WL 139188 (7th Cir. Ill.)

Bankruptcy Courts:

IN RE: Showalter, 86 B.R. 877 (B.C. W.D. Va. 1988)
IN RE: Hamm, 92 B.R. 386 (B.C. W.D. Mo. 1989)
IN RE: Kroh, 88 B.R. 972 (B.C. W.D. Mo. 1988)
IN RE: Stewart, 91 B.R. 489 (B.C. S.D. Iowa 1988)
IN RE: Fosco, 14 B.R. 918 (B.C. D.C. Conn. 1981)
IN RE: Sobel, 37 B.R. 780 (B.C. E.D. N.Y. 1984)
IN RE: Monahan, 125 B.R. 697 (B.C. D. R.I. 1991)
IN RE: Schwartz and Meyers, 130 B.R. 416 (B.C. S.D. N.Y. 1991)
IN RE: McDermott, 139 B.R. 50 (B.C. D. R.I. 1992)

is not persuasive. In *IN RE: Burgess*, the First Circuit, without any detailed analysis of § 523(a)(2)(A) merely states that the creditor was required to prove " . . . (3) the creditor actually relied on the misrepresentation, and (4) the creditor's reliance was reasonable under the circumstances." *IN RE: Burgess*, 955 F.2d 134, 140 (1st Cir. 1992). The Sixth Circuit in *IN RE: Philips*, 804 F.2d 930 (6th Cir. 1986) relied on *IN RE: Martin*, 761 F.2d 1163 (6th Cir. 1985) to conclude that § 523(a)(2)(A) cases require reasonable reliance, but the *Philips* court admitted that *Martin* dealt with a § 523(a)(2)(B) discharge. "Although *Martin* deals with § 523(a)(2)(B), we believe these principles apply with equal force to § 523(a)(2)(A)." *Philips* at 933.

The more persuasive view is that reasonable reliance is not required in non-dischargeability actions under § 523(a)(2)(A). A compelling argument for this position is the reasoning contained in *IN RE: Ophaug*, 827 F.2d 340 (8th Cir. 1987) and *In the Matter of Mayer*, 1995 WL 139188 (7th Cir. Ill.). In *Ophaug* the debtors had fraudulently obtained a loan from creditors, purportedly to purchase farm land. After securing a state court judgment, the creditors' judgment was discharged when the Bankruptcy Court concluded that the creditors' reliance on the misrepresentations of the debtor was unreasonable. *Id*. at 398.

In reversing the District Court's affirmance of the Bankruptcy Court, the Eighth Circuit Court of Appeals embarked on a thorough review of the statutory language of § 523(a)(2)(A) and § 523(a)(2)(B), as well as a review of the clearly established Congressional intent behind these sections. *Id*. at 342, 343. The Eighth Circuit concluded that

§ 523(a)(2)(A) contained no requirement of reasonableness of a creditor's reliance. *Id*. 343. "Finding the statute clear on its face and having no reason to think that Congress meant anything other than what it said, we can only conclude that § 523(a)(2)(A) does not require a creditor to prove that his reliance on the debtor's fraud was reasonable." *Id*.

In this case, as in *Ophaug*, the creditors' action was brought under § 523(a)(2)(A) which does not require that the creditors' reliance be reasonable.

In *Mayer*, the Seventh Circuit addressed the question of "whether a liar may obtain a discharge in bankruptcy by showing that the victim did not do enough to nose out the truth." *Mayer* at 1. The short answer the court supplied was: "Debts attributable to fraud may not be discharged, 11 U.S.C. § 523(a)(2)(A) and intentional deceit concerning a material proposition is fraud whether or not a more alert target would have smelled a rat." *Id*.

Mayer involved two transactions. the first where the debtors acted as "fronts" to secure loans for less creditworthy friends, and the second where the debtor fabricated a purchase order as proof of income to induce a lender to lend him funds. In neither instance was the creditor paid.

The Seventh Circuit Court of Appeals found the debtor in both instances had made material misrepresentations, on which the creditors had relied. *Id*. at 6, 7. In excepting the debts from discharge the court stated "fraud is an intentional tort, and victims need not take precautions against such torts in order to preserve their rights." *Id*. at 5.

The Court, as in *Ophaug*, looked to the intent of Congress in enacting § 523(a)(2)(A), to determine whether or not Congress had intended that a "reasonableness" element be included. It was noted that Congress had specifically provided for a "reasonable" element in § 523(a)(2)(B), but had not in § 523(a)(2)(A). *Id.*, at 4. "Congress deliberately distinguished the criteria for discharge according to the kind of document in which the falsehood appears" *Id.* The court also cited Prosser and Keeton on Torts, as well as the Restatement (2d) of Torts, as authority that "contributory negligence is not a defense to an intentional tort," *Id.* at 5. The plaintiff simply had no duty to investigate the truth of the defendant's statements. *Id.*

The holdings in *Ophaug* and *Mayer* are consistent with the purpose of the Bankruptcy Code. This Court has held that the central purpose of the Bankruptcy Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy "a new opportunity in life and a clear field for further effort, unhampered by the pressure and discouragement of pre-existing debt." *Grogan et al. v. Garner*, 498 U.S. 279 (1991) quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). However, this opportunity for a completely unencumbered new beginning is limited to the "honest but unfortunate debtor". *Grogan*, at 287. This requires a balance between the conflicting interests of the debtor's "fresh start" and the creditor's right to recover debts which Congress excepted from discharge. In determining the standard of proof required in determining dischargeability of debts in § 523(a)(2)(A) cases, this Court found that "we think it unlikely that Congress, in

fashioning the standard of proof that governs the applicability of these provisions, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud". *Id.* It is respectfully submitted that this Court should be equally reluctant to rule that Congress would favor the interests of the perpetrator of fraud over the victim of fraud by requiring reasonable reliance in § 523(a)(2)(A) cases absent express Congressional intent that such standard be applied.

III. THE ELEMENTS OF COMMON LAW FRAUD OR MISREPRESENTATION CONTAIN SUFFICIENT SAFEGUARDS TO PREVENT CREDITORS FROM RELYING ON OBVIOUSLY FALSE OR ABSURD REPRESENTATIONS.

Holding that reasonable reliance is not a required element of a non-dischargeability claim under § 523(a)(2)(A) will not open the door to patently unsupportable complaints of creditors. This concern has been addressed in the case of *IN RE: Fosco*, 14 B.R. 918 (B.C. D.C. Conn. 1981). The *Fosco* court reasoned that "When misrepresentation is so apparent that the plaintiff's conduct cannot be said to have been motivated by any reliance the recovery is barred where reliance is an ingredient of proof in the plaintiff's case." Any action based on fraud requires proof of the element of reliance to show a material nexus between the fraudulent act of the perpetrator and the harm to the victim, however, the common law of fraud does not have any reasonable investigation requirement. *In the Matter of Mayer*, 1995 WL 139188 at 5 (7th Cir. Ill., March 31, 1995). The Restatement of Torts, 2d, § 540 also states that reliance on a

misrepresentation must only be justifiable. Justifiable reliance does *not* require that the recipient of misrepresentation investigate the underlying assertion. *Id.* The recipient is justified in relying on its truth. *Id.* Only if the representation is known by the recipient to be false, or if its falsity is obvious, is reliance upon the assertion *not* justified. *Id.*, at § 541[7]

> "The plaintiff's conduct must not be so utterly unreasonable in the light of the information open to him, that the law may properly say that his loss is his own responsibility." William L. Prosser, *Law of Torts*, § 108 p. 715, (4th Edition 1971).

The findings of the Bankruptcy Court in the instant case criticized the creditor for failing to investigate.

> "A party is not entitled to, you, know, be in good faith and just not objectively (sic) reasonable. . . . case law establishes an objective test, and that is what would be reasonable for a prudent man to do under the circumstances." (R.84).

The Bankruptcy Court went on to add that the creditor should have undertaken certain investigations, including researching the Registry of Deeds. *Id.*

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[7] § 540 provides the following illustration of the lack of any duty of investigation by one who relies on misrepresentation:

1. A, seeking to sell land to B, tells B that the land is free from all encumbrances. By walking across the street to the office of the Registry of Deeds in the Courthouse, B could easily learn that there is on record an unsatisfied mortgage on the land. B does not do so and buys the land in reliance upon A's misrepresentation. His reliance is justifiable. Restatement (2d) of Torts, § 540 at 88.

As the above authorities demonstrate, application of this standard of "the reasonably prudent man" and the duty to investigate is *contrary* to the elements of common law misrepresentation. Therefore, the Bankruptcy Court held the creditor in this case to an incorrect standard. It is noteworthy that the Bankruptcy Court in ruling that the creditor should have researched the Registry of Deeds, runs directly contrary to the illustration of justifiable reliance contained in Section 540 of the Restatement of Torts (2d). Such investigation is *not* required. See footnote 7.

IV. IN THE INSTANT CASE, THE FIRST CIRCUIT'S RULING THAT REASONABLE RELIANCE IS REQUIRED FOR NON-DISCHARGEABILITY OF DEBTS IN § 523(a)(2)(A) CASES WAS ERRONEOUS. SINCE THE PETITIONERS PROVED ALL OTHER ELEMENTS, AND ALL NECESSARY ELEMENTS FOR NON-DISCHARGEABILITY UNDER § 523(a)(2)(A), THE CIRCUIT COURT'S DECISION MUST BE REVERSED.

The Bankruptcy Court in the instant case found that the debtor in this matter had made implicit misrepresentations to the creditors.

> "All right. I'm going to find that there was a misrepresentation by you and your attorney in sending letters to Mr. Field that clearly implied that it (the property) had not yet been transferred." (R.68).

Additionally, the Bankruptcy Court found that the petitioner did rely upon the fraudulent representation of the

debtor, and that this reliance resulted in harm to the petitioner.

> "The evidence clearly establishes that the Fields relied on the implicit misrepresentations in these letters that the property had not yet been transferred. It's also established that they relied on this . . . to their detriment, in that at the time of October, 1987 the real estate market was still booming in this State." (R.80, 81).

The debt was ultimately deemed dischargeable, however, because the petitioners' reliance was found not to be reasonable. *Id.* at 81. Since all of the necessary elements for non-dischargeability were found by the Bankruptcy Court, and only the unnecessary element of the reasonableness of the petitioners' reliance was decided against the petitioners, the Court of Appeals' decision affirming the District Court's and thus the Bankruptcy Court's decision should be reversed. " . . . The debtor whose conduct is fraudulent under § 523(a)(2)(A) should not be discharged from his fraudulent debt when his victim's conduct was merely less than prudent." *IN RE: Fosco,* 14 B.R. 921, 923 (B.C. D.C. Conn. 1981).

CONCLUSION

For the foregoing reasons, the petitioners request that the judgment of the Court of Appeals be reversed, and the case remanded for entry of judgment in the petitioners' favor on the claims under § 523(a)(2)(A) of the Bankruptcy Code.

Respectfully submitted,

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No. 94-967

In The

Supreme Court of the United States

October Term, 1995

WILLIAM FIELD and NORINNE FIELD,

Petitioners,

v.

PHILIP W. MANS,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The First Circuit

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STATEMENT OF THE CASE

Nature of the Case

This is a case brought against Respondent, Philip W. Mans ("Mans"), the debtor in a Chapter 7 bankruptcy proceeding, by Petitioners, William and Norinne Field (the "Fields"), to declare Mans' debt to them non-dischargeable. The "debt" in question was a guarantee by Mans of a corporate obligation.

The debts of a Chapter 7 debtor, as of the time of filing the petition in bankruptcy, are generally discharged under 11 U.S.C. § 727, with certain exceptions listed in 11 U.S.C. § 523.[1] Here, the Fields contend the general discharge provision is inapplicable under an exception in 11 U.S.C. § 523(a)(2)(A), which excepts debts for "an extension of credit . . . to the extent obtained by false pretenses, a false representation, or actual fraud . . . ."[2]

The Bankruptcy Court found that there was an "implicit misrepresentation" (R.79, 80), but that Section 523(a)(2)(A) did not apply because the Fields did not reasonably rely on the fraud (R.86).[3] The two reviewing

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[1] There are parallel discharge provisions under Chapter 11 Reorganizations (Sec. 1141), Chapter 12 Adjustments of Debt of Family Farmers (Sec. 1228), and Chapter 13 Adjustments of Debt of Individuals (Sec. 1328), each of which are similarly subject to some or all of the Section 523(a) exceptions.

[2] The claim was initially brought under the additional, alternate claimed exception for "willful and malicious injury" under Section 523(a)(6). The Fields withdrew that count at the beginning of trial. (R.3)

[3] It appears that the Bankruptcy Court addressed the other elements not at all or only summarily, since it realized at the

Courts affirmed the factual finding that the Fields had not reasonably relied, and affirmed the legal conclusion that reasonable reliance was required. This Court accepted certiorari on the issue whether reasonable reliance is a necessary element in proving a Section 523(a)(2)(A) exception.

Mans was not represented at the trial in the Bankruptcy Court, on either of the intermediate appeals, or on the petition for certiorari in this Court.

Statement of Facts

Petitioner's Statement of the Case is inaccurate or incomplete in several respects.

1. The Transaction

In the June 23, 1987 transaction, the real estate was not conveyed by the Fields to Mans. Instead, Mans'

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outset it would determine the case in Mans' favor on the reasonableness issue.

Thus, it interrupted both the Fields' closing argument (R.57, 61) and Mans' closing argument (70) to emphasize the preeminence of the "reasonableness" issue. It stated during its oral ruling that "the only issue left is whether this reliance was reasonable" (R.73) and "[t]he issue then boils down to the question of reasonable reliance." (R.81)

In contrast, it made only a cursory finding on the "implicit misrepresentation" (R.79, 80), and did not address at all the other elements of Section 523(a)(2)(A) such as the requirements (1) that the extension of credit be "obtained by" the fraud, (2) that the creditor rely on the fraud by taking or failing to take some action, and (3) that the fraud has to be fraud "of the individual debtor."

corporation, Sequoia Security Investment Corp. ("Sequoia"), purchased the stock of the Fields' corporation, Mascoma Lake Lodge Enterprises, Inc. ("MLL"), which held title to the two parcels in question. (Am. Cplt., ¶ 9; R.10)

There were two documents governing the parties' ongoing relationship after the acquisition, both dated June 23, 1987. The first was a promissory note (Jt. App'x at 50-52), made by Sequoia in favor of the Fields, and guaranteed by Mans.

The second was a second mortgage (PX O),[4] junior to the Mascoma Savings Bank, which ran from Sequoia as mortgagor to the Petitioners as mortgagees. Mans was not a party to the mortgage in his personal capacity. (PX O) While the mortgage contained a due-on-sale clause, this clause did not prohibit Sequoia from conveying the property, but simply gave the Fields the option of calling the note if Sequoia did convey it. (PX O) This point was not only conceded by the Fields' counsel (R.30-31), but was forcefully and repeatedly found by the Bankruptcy Court (R.46-48, 51, 59-60). As stated by the Court, "[t]here's no requirement that I know of that a party [to such a due-on-sale clause] has to tell the other party he's sold the property." (R.59)

The entire credit extended by the Fields to Sequoia – $187,000 – was extended on the date the transaction

---

[4] Plaintiffs' Exhibit N, included by Petitioners in the Joint Appendix (at 53-56) in lieu of PX O in error, is similar to the operative mortgage, but was executed by MLL rather than Sequoia.

closed, June 23, 1987, or some four months prior to the actions found to constitute "implicit misrepresentation." (Am. Cplt., ¶ 10) As admitted by the Fields, Sequoia paid the note in accordance with its terms from June 1987 until Mans filed for bankruptcy in November 1990 (Am. Cplt., ¶ 22; R.18), at which time the remaining balance was $144,266.09. (Am. Cplt., Prayer A, R.8, 22, 44). There was no "new" credit "extended" to Mans either at the time of the alleged fraud, October 1987, or at any time subsequent to that. (Am. Cplt., Para. 25-26; R.56)[5]

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[5] While the Fields contended in their Amended Complaint that they "*in effect* extended new credit in the amount of the then outstanding indebtedness" by being deprived of the knowledge that they could accelerate the note (Am. Cplt., Para. 26), the Bankruptcy Court did not accept the Fields' claim that they would have accelerated:

> [The Fields] *in their own minds* did rely on these representations subjectively and . . . *in effect* they extended the credit to Mr. Mans for another few years, . . . whereas they could have called the due on sale clause . . . .
>
> * * *
>
> My judgment is that what really happened here was . . . that the market was strong and Mans was paying and it's to some extent hindsight to now say, well, if we'd known then we would have called the loan. . . . *I think there is a lot [of] hindsight here as to* how serious this appeared to the Fields at the time and *whether they would have triggered the due on sale clause. That to me is the only explanation for their failure to take those easily available steps* of simply asking either DeFelice or Mans [whether there had been a transfer] or checking the title . . . .

(R.81, 84-85 (emphasis added))

Even if the Court had accepted the Fields' assertion that they would have accelerated the note if aware of the conveyance, this would not have made their failure to accelerate a

2. The Conveyance by Mascoma Lake Lodge

The criticized conveyance of property, in October 1987, was not made by Mans, but by the titleholder, MLL. (PX K) The deed was executed October 8 (and held in escrow), delivered October 12, and recorded October 19. (R.36-37)

3. The Claimed "Misrepresentation"

The so-called "implicit misrepresentation" by Mans – as alleged by the Fields and found by the Bankruptcy Court – consisted of two letters signed not by Mans but by the lawyer who had represented the corporate purchaser in the transaction. (Am. Cplt., Para. 16, 18; R.79-80) Both of these letters were addressed to the Fields' lawyer. (Jt. App'x at 46-47, 49)

The first claimed "misrepresentation" was in the October 9 letter (signed by the attorney the day after the deed was executed), and consisted of the following statement:

> We ask that Mr. & Mrs. Field, as the holders of the second Mortgage, consent in writing to the transfer of the property from Mascoma Lake Lodge Enterprises, Inc. to Crescent Beach Development.

(Jt. App'x at 46-47) There was no untrue statement in the letter.

"new extension of credit." No new funds were advanced, and there was no lengthening of the original due date.

The second claimed "misrepresentation" was in the October 27 letter (signed by the attorney) and in response to the Fields' October 19 letter agreeing to consent to the transfer only upon conditions, consisted of the following statement:

> My client would be willing to make the payments referred to in paragraph 1 and paragraph 3 of your letter, and would be agreeable to having future mortgage payments made by direct bank transfer. However, the fee of $10,000 is out of the question.

(Jt. App'x at 49) There was no untrue statement in the letter.

As found by the Bankruptcy Court, the "fraud" was the following:

> [I]n my judgment the letters from the defendant to the plaintiff in October of 1987 did contain an *implicit* misrepresentation, i.e., that the property had not yet been transferred and that it would be transferred upon the consent of the Fields. . . . In other words, the representation that's *implicit* in those letters is that we haven't yet transferred the property and we need your – want your consent to do so.

(R.79-80 (emphasis added)).

4. Unreasonableness Of Reliance

The Fields admitted several facts which, independently of the letters from Sequoia's counsel, gave them a strong reason to suspect that the property had been conveyed, and made any reliance on the letters "unreasonable."

First, Mr. Field admitted that shortly after receiving the letters purportedly telling him there had been no conveyance from Sequoia, he was informed by a business associate, Sal Lucido, that Lucido had visited the property and spoken with an Alex DeFelice, who claimed to be the "new owner" of the property. (R.12-13; 20-21; 26-27)

Second, Mr. Field admitted that, even armed with the knowledge that DeFelice claimed to be "one of the new owners," he failed to ask his lawyer to check the title in the recorder's office. (R.49-50) This was so even though the Fields already had a lawyer who was involved in the transaction, and even though a check of the land records would have entailed only a half hour of work. (R.49-50)

Third, Mr. Field admitted that, even armed with the knowledge that DeFelice claimed to be "one of the new owners," he failed to ask Mans the direct question whether there had been a conveyance. (R.8, 53) In Mr. Field's own words:

> Q. Did you ask him if, in fact, he had sold the property?
>
> A. No. I don't believe I ever confronted because first, I never really thought that that could happen without my mortgage being released. Perhaps I was stupid in that –

(R.53) This was true even though Field visited the property occasionally and spoke to Mans on multiple occasions, both on the property and elsewhere. (R.8, 24-26)

The Bankruptcy Court expressly cited these three factors in finding the Fields' reliance to be "unreasonable." (R.81-86)

5. No Finding On Proximate Cause

The Bankruptcy Court made no finding that there was an "extension of credit" to Mans "obtained by . . . a false representation or actual fraud." (R.75-87)[6] Neither did the District or Circuit Courts address this issue (Pet. for Cert. at 15-16, 17-21, and 23-31), apparently since their agreement with the Bankruptcy Court on the reasonable reliance issue was sufficient standing alone to affirm.

6. The Appellate Rulings

The reviewing District and Circuit Courts both agreed with the Bankruptcy Court's conclusion that reasonableness of reliance is required, and affirmed (on a "clearly erroneous" standard) the Bankruptcy Court's factual finding that the Fields' reliance was not reasonable. (Pet. for Cert. at 15-16, 17-21, and 23-31) As a result, neither of the reviewing courts reached consideration of the required element of Section 532(a)(2)(A) which the Bankruptcy Court never addressed – whether there was an "extension of credit . . . *obtained by*" the letters. A

[6] The Bankruptcy Court did state that "*in effect* they extended the credit to Mr. Mans for another few years." (R.81) However, as discussed below at pages 32-33, the Court did not consciously address the requirement under 11 U.S.C. § 523(a)(2)(A) that the extension of credit must be proximately *caused* by the fraud, and that the extension of credit must occur after the fraud.

finding in Mans' favor on this issue would also have resulted in a verdict in Mans' favor.[7]

SUMMARY OF ARGUMENT

I. The plain language of Section 523(a)(2)(A) is simply silent as to any "reasonableness" requirement. There is nothing in the express inclusion of the requirement in Section 523(a)(2)(B) to suggest Congress consciously intended to omit "reasonableness" from (a)(2)(A). If anything, the use of the word "fraud" incorporates all five of the elements of the common law action for fraud, one of which is *reasonable* reliance.

II. A fair reading of the legislative history of the Bankruptcy Code of 1978 shows that Congress did not consider the "reasonableness" requirement of Section 523(a)(2)(A) at all.

[7] Even if it finds reasonableness is not required under Section 523(a)(2)(A), this Court should affirm, or at least remand for additional factual findings, because the proximate cause element was not met, as discussed at pages 32-33 below.

It is black letter law that a reviewing Court should affirm not only on the ground of the decision below, but also on any ground on which the lower court *could* have relied. *Smith v. Phillips*, 455 U.S. 209, 215 n. 6 (1982) ("[r]espondent may, of course, defend the judgment below on any ground which the law and record permit"); *Dandridge v. Williams*, 397 U.S. 471, 475 n. 6 (1970) ("[t]he prevailing party may, of course, assert in a reviewing court any ground in support of his judgment, whether or not that ground was relied upon or even considered by the trial court").

III. Leaving aside differences in terminology or expression, virtually all of the lower courts addressing the issue have required "reasonable reliance" in so many words, or its functional equivalent if using other terminology. In explaining the requirement, virtually all courts have ruled that, although a lender with no reason to believe a statement is false has no duty to investigate, a lender which independently has "actual knowledge of the fraud or any strong reason to suspect it" does not meet the reliance requirement without taking some action to check it out. Whether or not the courts call this standard "reasonableness," it is the appropriate standard, and this Court should define it to mean "reasonableness." (The sole exception to this standard among circuit courts is the Eighth Circuit in the 1987 *Ophaug* case, which is poorly reasoned.)

IV. There are compelling policy reasons to retain the "reasonableness" requirement. These include (1) the need to avoid abusive creditor practices, particularly in the area of credit card debt, which is accounting for an ever-increasing portion of Section 523(a)(2)(A) cases; (2) the need to promote consistency with the law of common law fraud and securities fraud, subjects under which related litigation should provide a frequent basis for collateral estoppel in Section 523(a)(2)(A) cases; and (3) the need to protect underfinanced debtors from creditors' over-balanced litigation leverage.

V. Separately from the "reasonable reliance" requirement, the case should be affirmed because the extension of credit here was not "obtained by the alleged fraud," as required by the express language of Section 523(a)(2)(A). It is undisputed that the credit was extended

in June 1987, and that the alleged misrepresentation did not occur until October 1987, some four months later.

ARGUMENT

I. THE PLAIN LANGUAGE OF SECTION 523(a)(2) SHOWS *NO* CONSCIOUS ATTEMPT BY CONGRESS TO ADDRESS THE "REASONABLENESS" ISSUE IN SUBSECTION (A) AT ALL

Contrary to Petitioners' suggestion (Pet. Br. at 9-10), the plain language of Section 523(a)(2) does not state – "clearly" or otherwise – that "the reasonable reliance element applies only to claims of non-dischargeability brought under Section 523(a)(2)(B)."[8] It is silent on the issue.

Nor is it appropriate to imply an absence of the element by comparing the language with Subsection (B), as both Petitioners and the United States do. If their

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[8] Section 523(a)(2) provides in pertinent part that a debtor is not entitled to be discharged from any debt to the extent that the debt was obtained by:

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing –

- (i) that is materially false;
- (ii) that at the time he knew they were false;
- (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
- (iv) that the debtor caused to be made or published with intent to deceive

principle of implied statutory construction were applied, this Court would have to excise several other implied elements of Subsection (A) which have been settled for decades, including the following:

– "Actual reliance" itself would no longer be required, since that element is enumerated expressly in (B) but not in (A). No one suggests that actual reliance is not a required element. As stated in a leading bankruptcy treatise:

> Unlike subsection (B) there is no explicit statement that the creditor must have relied in order to state a cause of action, but *without exception the courts have read a reliance requirement into the creditor's proof under (2)(A). Despite the fact one might draw the opposite inference from the presence of such an explicit reliance condition in (B) and the absence of one in (A), this is a sensible reading.*

Epstein, Nichols and White, *Bankruptcy* § 7-26 at 503 (1992). Indeed, even petitioners admit that despite the same presence of the term in (B) and absence of it in (A), it is a "given" in (A) that proof of reliance is required. ("Question Presented For Review," Pet. Br. at i)

– "Materiality" would also be excised, since that element is similarly enumerated in (B) but not in (A). Materiality, like actual reliance, has long been an undisputed element. *E.g., In re Mayer*, 51 F.3d 670, 676 (7th Cir. 1995); *In re Van Horne*, 823 F.2d 1285 (8th Cir. 1987); *In re Homer*, 168 B.R. 790 (N.D.Ga. 1994).

– "Intent to deceive," would also be excised, since that element is similarly enumerated expressly in (B) but not in (A). Scienter has also been an undisputed element

of (A). *In re Mayer*, 51 F.3d 670, 674-75 (7th Cir. 1995) (court refuses "to strip all intent components from § 523(a)(2)(A)"); *In re Miller*, 39 F.3d 301, 306-07 (11th Cir. 1994); *In re Philip G. Menna Century 21 Balfour Real Estate*, 16 F.3d 7, 10 (1st Cir. 1994); *In re Kirsh*, 973 F.2d 1454, 1457 (9th Cir. 1992); *In re Foreman*, 906 F.2d 123, 127 (5th Cir. 1990); *In re Mullet*, 817 F.2d 677, 680 (10th Cir. 1987); *In re Phillips*, 804 F.2d 930, 932 (6th Cir. 1986).

If the express language supported either side here at all, it would support the *inclusion* of a "reasonableness" requirement based on the commonly understood meaning of the term "fraud,"[9] which is a word of art incorporating all five of the common law elements of a fraud case.[10]

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[9] While this construction does not account for the "other" two enumerated grounds under (a)(2)(A) – "false pretenses" and "false representation" – it appears that these grounds are other terms for "actual fraud." There is virtually no authority explaining these additional terms, and the only courts addressing the subject apparently conclude that there is no meaningful distinction. *In re Mayer*, 51 F. 3d 670, 674 (referring to the three terms, "[r]edundancy is common in statutes; we do not subscribe to the view that every enacted word must carry independent force"); *In re Schnore*, 13 B.R. 249, 251 (D. Wis. 1981) ("conceptually difficult to distinguish the terms").

[10] In New Hampshire (whose substantive law governs any cause of action for fraud in the instant transaction), for example, the elements of a fraud claim are the following:

(1) misrepresentation of a material fact;
(2) fraudulent intent;
(3) reliance;
(4) *justifiable reliance*; and
(5) resulting damages.

N.H. Civil Jury Instructions (1994), Pattern Instruction 22.1 (which expressly uses the word "reasonable" in the stated support as interchangeable with "justifiable"). *See also, Caledonia,*

This Court has itself endorsed the construction that the term "fraud" includes all of its common law elements:

> [A]ll creditors who have secured fraud judgments, *the elements of which are the same as those of the fraud discharge exception*, will be exempt from discharge under collateral estoppel principles.

Grogan v. Garner, 498 U.S. 279, 285 (1991). *See also*, *In re Kirsh*, 973 F.2d 1454, 1458 (9th Cir. 1992) ("most likely that Congress was referring to the common law definition of fraud").[11]

II. THE LEGISLATIVE HISTORY SHOWS NO CONGRESSIONAL INTENT TO CHANGE THE ALREADY EXISTING "REASONABLENESS" REQUIREMENT

Petitioners' legislative history argument (Pet. Br. at 11-19) is that by expressly enumerating the "reliance" element in (a)(2)(B) in 1978, Congress showed an "intent" that it no longer be contained in (a)(2)(A). Indeed, the

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Inc. v. Trainor, 123 N.H. 116 (1983) (plaintiff must show . . . that the misrepresentation caused plaintiff "*reasonably* to rely to his detriment"); *MAC Finance Plan of Nashua, Inc. v. Stone*, 106 N.H. 517, 519 (1965) (same).

See also page 28 below for a detailed discussion of the "justifiable reliance" element of common law fraud as addressed by *Prosser* and the *Restatement of Torts*.

[11] The Government's insistence (Br. of U.S. at 9) that every word (or omission) in a statute is the result of careful Congressional intent is somewhat exaggerated. As stated by the Seventh Circuit, "[r]edundancy is common in statutes; we do not subscribe to the view that every enacted word must carry independent force." *In re Mayer*, 51 F. 3d 670, 674 (7th Cir. 1995).

United States in its *amicus* Brief takes this contention a step further, stating that Congress' intent to treat the reliance issue in the two subsections "was quite deliberate." (Br. of U.S. at 14-15)[12]

There is absolutely no support for this position in Congress' written record. While there are a great many legislative explanations of Subsection (B), there is not a single reference in those explanations to what the ramifications of the (B) changes on (A) would be. Since the courts had already developed the judicial gloss that "reasonableness" is required under the predecessor of (a)(2)(A),[13] Congress would have mentioned that it was changing the existing case law if that had really been its "intent." It did not.

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[12] This contention (Br. of U.S. at 14-15) is based solely on a statement of Senator DeConcini that "Subparagraph (A) is mutually exclusive from subparagraph (B)," a statement which in reality explains that (B) covers "written financial statements" whereas (A) covers anything *other than* written financial statements. There is nothing at all to suggest that Senator DeConcini was referring to the reasonableness issue.

[13] Petitioners are simply not correct where they state (Pet. Br. at 14) that Courts only "*began* to require reliance to be reasonable" *subsequent* to the 1978 changes. *E.g.*, *Bazemore v. Stehling*, 396 F.2d 701 (5th Cir. 1968); *In re Hemphill*, 1 Bankr. Ct. Dec. 1181 (N.D. Ga. 1975); *In re Dolrick*, 374 F. Supp. 84 (N.D.Ill. 1974). As retrospectively summarized by the Tenth Circuit, cases under the prior Bankruptcy Act interpreting this section quickly developed the judicial gloss that "actual reliance must be reasonable." *In re Mullet*, 817 F.2d 677, 679 (1987). *Accord*, B. Zaretsky, The Fraud Exception to Discharge Under the New Bankruptcy Code, 53 Am. B.R.L.J. 253, 258 (1979).

Indeed, in a slightly different context this Court has expressed its own reservations about reading too much meaning into Congress' legislative silence. *Grogan v. Garner*, 498 U.S. 279, 290 (1991) ("it would not be reasonable to conclude that in enacting Section 523 Congress silently endorsed a background rule that clear-and-convincing evidence is required"). Indeed, various authorities have questioned whether legislative history is *ever* appropriate in interpreting Congressional intent, in part because reports and statements do not represent the result of a majority vote, and because many legislators purposely place material in the records to attempt to influence the subsequent judicial interpretation when they know it cannot command a majority. *See, Wallace v. Christensen*, 802 F.2d 1539, 1559 (9th Cir. 1986) (Kozinski, J., concurring); *Hirschey v. F.E.R.C.*, 777 F.2d 1, 7-8 at n. 1 (D.C. Cir. 1985) (Scalia, J., concurring).

Moreover, the House/Senate conference committee reported generally that "Subparagraph (A) is *intended to codify current case law* . . . . " 124 Cong. Rec. H 11,095-6 (Sept. 28, 1978); S 17,412-13 (Oct. 6, 1978). This point is further emphasized by the Ninth Circuit as follows:

> Nor is there any reason to believe that Congress itself intended to alter the common law when it adopted section 523 (a)(2)(A). Rather, . . . it is most likely that Congress was referring to the common law definition of fraud when it adopted that section.

In re Kirsh, 973 F.2d 1454, 1458 (9th Cir. 1992).

The plausible explanation of why Congress expressly addressed (B) but not (A) is that it had to address (B) to

resolve a conflict between the House and Senate versions of that section.[14]

Nor did it occur to any Circuit Court (other than the Eighth Circuit in the 1987 *Ophaug* decision) that the change in Subsection (B) – without more – signaled a silent Congressional "intent" to abandon the long-established "reasonableness" requirement of (A). After 1978, the Circuit Courts, as well as the lower courts, continued nearly unanimously to require reasonable reliance. Even Petitioners have found and cited 33 of these cases. (Pet. Br. at 14-15, n. 5)

III. THE ALMOST UNANIMOUS MAJORITY RULE IN THE CIRCUIT COURTS AND THE LOWER COURTS IS THAT "REASONABLENESS" OR ITS FUNCTIONAL EQUIVALENT IS REQUIRED

Although there are differences in analysis or in terminology,[15] the overwhelming majority of lower courts has adopted either an objective "reasonableness" requirement or its functional equivalent. The "functional equivalent" is that degree of care which a reasonably prudent lender

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[14] As stated by the conference committee, (B) "represents a compromise between the position taken in the House bill and the Senate amendment with respect to the false financial statement exception." 124 Cong. Rec. H 11,095-6 (Sept. 28, 1978); S 17,412-13 (Oct. 6, 1978). Since there never was differing language as to Subsection (A), there was no need for that section to be addressed in conference.

[15] The problem that different courts have used differing, inconsistent terminology to refer to the interrelated concepts of reliance and reasonableness has been highlighted in *In re Cox*, 1995 WL 349089 at 9 (Bankr. D. Mass. June 9, 1995).

would exercise in light of all the facts and circumstances. This standard might fluctuate based on the nature of the lender (institution or private individual) and circumstances (e.g., whether some fact placed the lender on notice that something was amiss and warranted investigation).[16]

This section will summarize the lower court decisions and specifically address the key Court of Appeals cases which Petitioners claim support their position – *Mayer, Kirsh, Allison* and *Ophaug*. As shown below, *Mayer* and *Kirsh* support Mans, not Petitioners, and *Allison* contains only dictum on the point and contains some language supportive of Mans. Only *Ophaug* directly supports Petitioners.

A. The Weight Of Lower Court Authority Overwhelmingly Favors A "Reasonableness" Requirement

As pointed out by Petitioners (Pet. Br. at 14-15), the overwhelming majority of decisions on point (33 to 12) have required "reasonable" reliance. While Petitioners claim that three circuits (the Fifth, Seventh, and Eighth) have rejected "reasonableness," and contend that an additional one (the Ninth) employs an altogether different "justifiable" standard, proper analysis of three of the cited decisions – the *Mayer, Kirsh* and *Allison* cases – demonstrates that they actually require "reasonableness"

[16] Under either the "reasonableness" standard or its functional equivalent contained in some decisions, Mans would be discharged.

or its functional equivalent, as shown below. Thus, five of the circuits addressing the issue support Respondent, and only one (the Eighth in *Ophaug*) supports Petitioners.

Moreover, the *Ophaug* case, decided in 1987, is now dated. None of the five subsequent circuits ruling on the issue has followed *Ophaug* without significant qualifications which result in some form of the "reasonableness" requirement.[17]

B. *In re Mayer* Requires The Functional Equivalent Of "Reasonableness"

Petitioners rely heavily on (Pet. Br. at 16-19), but do not quote the actual holding of, *In re Mayer*, 51 F.3d 670 (7th Cir. 1995). Although the Seventh Circuit analyzed the issue in nomenclature derived from its treatment of Rule 10b-5 cases, the *Mayer* holding required the functional equivalent of "reasonableness."

Mayer concerned a single debtor involved in two separate transactions, which were consolidated on appeal. In the first transaction, Mayer and his wife borrowed $135,000 to purchase and operate a hotel, which they secretly conveyed to their friends the Montis through a power of attorney. Since all of the loan documents presented to the bank, including financial statements and tax returns, appeared normal on their face, the

[17] In addition, several recent cases not cited by Petitioners also require "reasonableness." *In re Phillip Menna Century 21 Balfour Real Estate*, 16 F.3d 7 (1st Cir. 1994); *In re McLaren*, 3 F.3d 958, 961 (6th Cir. 1993); *In re Cox*, 1995 WL 349089 (Bankr. D. Mass. 1995).

Court found no obligation for the bank to undertake an investigation to "nose out the truth." 51 F.3d at 672-73.

In the second transaction, Dr. Mayer borrowed $100,000 from a finance company which was to be repaid from the proceeds of a substance abuse manual he had written. To lend credence to this claim, Mayer showed the finance company a copy of a purchase order from the Chicago Board of Education for 5,000 copies of the manual. The purchase order turned out to be a fake, with a forged signature. Although the finance company made a reasonable investigation by checking with the Board, it received responses which did not put it on notice that anything was amiss. 51 F.3d at 673.

After discussing (but neither embracing or rejecting) the approach of *Prosser* and the *Restatement of Torts*, the Court made the following pronouncements:

> A "reliance" requirement . . . excludes recovery if the investor *knows or suspects the truth*. Reliance means the conjunction of a material misrepresentation with causation in fact.
>
> * * *
>
> More generally, *an investor cannot close his eyes to a known risk. If the investor possesses information sufficient to call the representation into question, he cannot claim later that he relied on or was deceived by the lie*. This is not because he has a duty to investigate lies or prevent intentional torts, though; it is, rather, because the false statement is not material under the circumstances.
>
> * * *
>
> A victim who lacks access to the truth, *and has not been alerted to facts that would alert him to the truth*, is not to be denied recovery under the securities laws – or be blocked by a discharge under the bankruptcy laws – just because he did not conduct a more thorough investigation.

51 F.3d at 676.

Thus, the key for the Seventh Circuit was whether the creditor had "actual knowledge of the fraud [or] any strong reason to suspect one." 51 F.3d at 676. This is the functional equivalent of "reasonableness."

If the *Mayer* test ("actual knowledge or strong reason to suspect") were applied to the instant creditors, they would not meet the reliance element. While Petitioners had no initial obligation to conduct an investigation, that changed when Mr. Field was told that DeFelice was on the property and claiming to be the new owner. At that point he had "strong reason to suspect," and should have taken at least minimal action to test his information, such as asking Mans directly or running a title search.

C. *In re Kirsh* Requires The Functional Equivalent of "Reasonableness"

Petitioners point out (Pet. Br. at 14) that *In re Kirsh*, 973 F.2d 1454 (9th Cir. 1992), adopts a required element of "justifiable" reliance rather than "reasonable" reliance.[18]

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[18] While the *Kirsh* court suggested there may be a difference between these two terms, others have found them to be interchangeable. For example, the *Mayer* court appears to use them interchangeably, 51 F. 3d at 675, and the drafters of the official New Hampshire Civil Jury Instructions (1994) use the term "justifiable" in the text while citing cases in support which use the word "reasonably." See n. 9 above.

This does not aid Petitioners since "justifiableness" is the functional equivalent of "reasonableness."

In its analysis the *Kirsh* court mentioned the availability of three potential modifiers to place in front of "reliance" – "actual," "justifiable" and "reasonable" – but made no attempt to explain the difference between them. 973 F.2d at 1457. After reciting the language from Prosser and the Restatement, the Court chose the term used by each of those authorities, "justifiable." 972 F.2d at 1457.

What is more important than the choice of modifier is the Court's analysis of what it meant by the term:

> It is a more subjective standard which *takes into account the knowledge and relationship of the parties themselves*. Thus, a person of normal intelligence, experience and education . . . may not put faith in representations which any such normal person would recognize at once as preposterous.
>
> * * *
>
> *[I]f a person does have "special knowledge, experience and competence" he may not be permitted to rely on representations that an ordinary person would properly accept.* In other words, while *reasonableness of behavior is a factor* in the mix, it is only a factor.

973 F.3d at 1458 (emphasis added and citation deleted).

In the *Kirsh* case, the Court found no "justifiable" reliance because the creditor was a sophisticated business lawyer who was the debtor's best friend and who knew

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One explanation is that, since Prosser and the Restatement of Torts use the word "justifiable" in summarizing the elements of common law fraud, those courts which rely on either of those sources tend to use the same word.

the details of the debtor's finances, including the fact he could not pay bills on time, and who knew that the normal standard of care was to obtain a title report. 973 F.2d at 1454, 1461.

If the *Kirsh* test were applied to the instant case, there would be no "justifiable reliance" because De Felice's statements gave the Fields enough ground to doubt that they should have investigated.

D. *In Re Allison* Requires The Functional Equivalent Of "Reasonableness"

Petitioners contend (Pet. Br. at 15) that *In re Allison*, 960 F.2d 481 (5th Cir. 1992), "do[es] not require reasonable reliance." That may be true semantically, but the Court went on to define "actual reliance" in a way that includes the functional equivalent of "reasonableness." The relevant language is the following:

> We therefore conclude that reasonable reliance is not, as a matter of law, required under section 523(a)(2)(A). *While so concluding, we hasten to add that the reasonableness of reliance is strong circumstantial evidence in the factual determination regarding actual reliance, which is an element of subparagraph (A).*

960 F.2d at 485 (emphasis added).

In the instant case, it appears that the Bankruptcy Court's finding of "reliance, but no reasonableness," expressed in the *Burgess* terminology of the First Circuit, could also have been articulated in *Allison* terminology as "circumstantial evidence" showing there never was actual reliance in the first place. This is emphasized by

the following factual finding of the Bankruptcy Court in this case:

> My judgment is that what really happened here was . . . that the market was strong and Mans was paying and it's to some extent hindsight to now say, well, if we'd known then we would have called the loan. . . . *I think there is a lot [of] hindsight here as to* how serious this appeared to the Fields at the time and *whether they would have triggered the due on sale clause. That to me is the only explanation for their failure to take those easily available steps* of simply asking either DeFelice or Mans [whether there had been a transfer] or checking the title . . . .

(R.84-85 (emphasis added))

In addition, the quoted *Allison* language is only *dictum* because there was a finding that the creditor's reliance was reasonable. 960 F.2d at 485.

E. *In re Ophaug* Does Support Petitioners But Is Poorly Reasoned

It is true that *In re Ophaug*, 827 F.2d 340 (8th Cir. 1987), holds that "the creditor need not prove that his reliance was reasonable." 827 F.2d at 343.

However, *Ophaug*'s conclusion is based entirely on (1) the fact that Subsection (a)(2)(A) does not contain the word "reasonable," whereas Subsection (a)(2)(B) does, 827 F.2d at 342; and (2) its treatment of legislative history similar to that urged by Petitioners on the Court here, 827 F.2d at 343. For the reasons set forth in Sections I and II of this Brief, those "reasons" are inappropriate.

In addition, it is noteworthy that although *Ophaug* is now eight years old and, although there have been numerous subsequent Court of Appeals' rulings on the subject, only one Court of Appeal has followed it (*Allison*), and that with serious qualification.

IV. IMPORTANT POLICY CONSIDERATIONS MANDATE A "REASONABLENESS" REQUIREMENT

There are three compelling policy reasons why the reasonableness element should not be removed from Subsection (A).

A. Elimination Of The "Reasonableness" Requirement Would Invite Abusive Creditor Practices

The debt in this case was a loan from non-commercial lenders to a private entrepreneur, but that is not the typical fact pattern. By far the bulk of Subsection (a)(2) cases consist of institutions lending to individuals. Increasingly, the debtors are low-income consumers, and the debt in question is credit card debt which has been recklessly extended by the lenders.[19]

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[19] As stated by Professor Warren, the dramatic growth in personal bankruptcies from 1981 to 1991 may likely be due to changes in credit practices. By 1991, the biggest growth area in the extension of credit card debt was to the poor. Professor Warren cites the following dramatic figures from a speech to the VISA Bankruptcy Program in 1993:

> [B]etween 1977 and 1989, the proportion of households earning between $10,000 and $20,000 and owning at least one credit card doubled from 18% to 37%. In 1989, *27.9% of the households in this income range*

As defaulting credit card borrowers and other high-risk borrowers have skyrocketed, portions of the credit industry has attempted to abuse Subsection (a)(2)(A) to prevent debtors from being discharged. They have done this by asserting that the debtor's signing of a charge slip is an "implied misrepresentation" of an intention to pay if the debtor was insolvent at the time. *See*, Epstein, Nichols & White, *Bankruptcy* § 7-26 at 498 (1992); *In re Karelin*, 109 B.R. 943 (9th Cir. 1990); *In re Cox*, 1995 WL 349089 (Bankr. D.Mass. June 9, 1995) (n. 23 of *Cox* assembles a lengthy list of these cases); *In re Wood*, 373 F. Supp. 105 (E.D.Wis. 1974); *In re Landon*, 20 C.B.C. 2d 731 (M.D. Fla. 1989).

Similarly, if this Court removes the "reasonableness" hurdle, many lenders will take the very action which concerned Congress under Subsection (B),[20] that is, they will encourage some false or incomplete statement from the borrower at the time credit is extended so that they

> *reported credit card debt. . . . Even among households with incomes less than $10,000, 15% reported having credit card debt.*

E. Warren, A Financial Comparison, 68 Am.B.R.L.J. 133 (1994). The press has documented the practices of "high-risk" lenders, some of which approve virtually every application they receive even though they know many of the borrowers will be unable to repay. *See, e.g.*, "Last-Ditch Loans: Bankrupts Who Drive Are Lucrative Market To a Growing Lender," *Wall Street Journal* (June 28, 1995).

[20] H.R. 365, 95th Cong., 2d Sess. (1978); reprinted in 1978 U.S. Code Cong. & Admin. News 6091, 92.

later can avoid discharge. This danger is no less real under (A) than it was under (B).

Under current law the "reasonableness" element provides a check on these creditors. While "reasonableness" is a factual determination decided on a case by case basis, in the case of an institutional lender "reliance" usually means that some credit check must be made before extending credit, and that no credit be extended to borrowers who are known bad risks. If the "reasonableness" requirement is removed, it will open the floodgates for banks and credit card lenders to challenge every credit card bankruptcy, even where they themselves were reckless in extending credit. It will encourage the reckless extension of credit to consumers who are not disciplined enough to handle it and should not have it.

B. Retaining the "Reliance" Requirement Would Promote Consistency With Common Law Fraud And Securities Fraud Law

As pointed out by this Court, a proceeding in Bankruptcy Court to determine dischargeability is frequently preceded by a related state court action for common law fraud, or by a federal court action for securities fraud. *Grogan v. Garner*, 498 U.S. 279, 284-85, esp. fn.11 (1991) ("we now clarify that collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to Sec. 523(a)"). An example of a case in which the state court judgment conclusively determined the discharge exception is *In re Mayer*, 51 F.3d 670, 673 (1995).

Of course, in order for collateral estoppel principles to avoid re-litigation of facts which have already been

determined, as well as to avoid inconsistent results, there must be identity of elements. Restatement (2d) of Judgments § 27 (1982). The principal types of actions which can be expected to form the basis for collateral estoppel are common law fraud actions and Rule 10b-5 actions.

A common law action for fraud requires "justifiable" or "reasonable" reliance, as demonstrated by the two leading authorities on torts. The Restatement of (2d) of Torts, § 541 and Comment "a" thereto state that a recipient of a fraudulent misrepresentation is "required to use his senses," and cannot "blindly rely upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation"). Similarly, Prosser states that not only must there be reliance but the reliance must be "justifiable under the circumstances." PROSSER AND KEETON ON TORTS § 108 (5th Ed. 1994) While justifiability does not require an investigation in every circumstance, PROSSER clarifies that it does in some:

> *[W]here*, under the circumstances, the facts should be apparent to one of [plaintiff's] knowledge and intelligence from a cursory glance, or *he has discovered something which should serve as a warning that he is being deceived*, [then] *he is required to make an investigation of his own.*

Id. (emphasis added).

An action for securities fraud under S.E.C. Rule 10b-5 also requires "justifiable" or "reasonable" reliance.[21] The

[21] *E.g.*, *Cooke v. Manufactured Homes, Inc.*, 998 F.2d 1256, 1261 (4th Cir. 1993) (false statement or omission "upon which plaintiff justifiably relied"); *Fine v. American Solar King Corp.*, 919 F.2d 290, 300 (5th Cir.), *cert. dismissed*, 112 S. Ct. 576 (1990) ("justifiable reliance"); *Teamsters Local 282 Pension Trust Fund v. Angelos*, 762 F.2d 522, 530 (7th Cir. 1985) ("justifiable reliance . . . is a limitation on a rule 10b-5 action"); *Zobrist v. Coal-X, Inc.*, 708 F.2d 1511, 1517 (9th Cir. 1983) ("justifiable reliance"); *Shores v. Sklar*, 647 F.2d 462, *cert. denied*, 459 U.S. 1102 (1981) ("requirement that reliance be reasonable or justifiable"); *Nye v. Blyth Eastman Dillon & Co., Inc.*, 588 F.2d 1189, 1197 (8th Cir. 1978) ("reasonableness").

Rule 10b-5 cases which address what those terms mean use language strikingly similar to the test which Respondent urges in Section II above is the meaning of "reasonableness" or its functional equivalent. For example, the Fifth Circuit states that reasonable or justifiable reliance means that

> plaintiff must not intentionally refuse to investigate in disregard of a risk known to him or so obvious that he must be taken to have been aware of it.

Shores v. Sklar, 647 F.2d 462, 470 at n. 6, *cert. denied*, 459 U.S. 1102 (5th Cir. 1981) (quoting W. Prosser). Similarly, in a Rule 10b-5 case cited by the *Mayer* court for guidance in analyzing the reliance requirement under Section 523(a)(2)(A) of the Bankruptcy Code, the Seventh Circuit states:

> [A]n investor cannot close his eyes to a known risk. *If the investor . . . possesses information sufficient to call the representation into question, he cannot claim later that he relied on or was deceived by the lie.*

Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522, 530 (1985) (emphasis added). *See also, Sunstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1044, 1048 (7th Cir. 1977) (same); *TBG, Inc. v. Bendis*, 841 F. Supp. 1538,

1558-59 (D. Kan. 1993) (no reasonable reliance where buyer closed eyes and refused to investigate known or obvious risk).

Since common law fraud actions and Rule 10b-5 actions require "reasonable" reliance, this element should be retained in Subsection (A). Without it, a debtor could win his case for securities or common law fraud only to face new exposure in the Bankruptcy Court.

C. Retaining the "Reliance" Requirement Would Protect Underfinanced Debtors From Creditors' Overbalanced Litigation Leverage

It has long been established that to promote the relief of debtors, the bankruptcy statute's exceptions to discharge should be strictly construed. *Gleason v. Thaw*, 236 U.S. 558, 562 (1915); *In re Black*, 787 F.2d 503, 505 (10th Cir. 1986); *In re Long*, 774 F.2d 875, 879 (8th Cir. 1985); *Davis-Paxson Co. v. Caldwell*, 115 F.2d 189, 191 (5th Cir. 1940), *cert. denied*, 313 U.S. 564 (1941).

As Congress observed, debtors seldom have the funds to engage in battles over the applicability of the exceptions to discharge, whereas creditors do. *In re Cox*, 1995 WL 349089 (Bankr. D.Mass. June 9, 1995) (citing H.R. Rep. 595, 95th Cong.). For example, the creditor typically begins with a salvo of canned discovery requests, which increases the financial burden on an already strapped

debtor. *In re Cox*, *id*. Indeed, the mere threat of litigation over exceptions to discharge and its attendant costs are often enough to induce the debtor to settle for a reduced sum, in order to avoid the costs of litigation. Thus, "creditors with marginal cases are usually able to have at least part of their claim excepted from discharge (or reaffirmed), even though the merits of the case are weak." *Id*.

The disparity of litigating power is well illustrated by the instant case. Here, Mans – a layperson – represented himself in the Bankruptcy Court and in both reviewing courts, precisely because the circumstances which led to his bankruptcy also left him without funds to engage counsel. At the trial, he offered no defendant's exhibits, called no witnesses (R.55),[22] and made no legal argument to the Court except to respond to the Court's questions (R.65-74).

Retaining the requirement of "reasonable" reliance would promote fairness by providing an objective way to ensure that the claimed reliance is genuine, and removing debtors' exposure to subjective, complex arguments which they lack the funds and expertise effectively to oppose.

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[22] While they are not in the record, there exist documents tending to show that the Fields had evidenced a willingness for title to be held otherwise than by Sequoia and contemplated a transfer upon Sequoia's arranging for another investor to participate, as ultimately occurred. If introduced into evidence, this evidence would have cast the alleged "implied misrepresentation" in a very different light.

V. SINCE THE CREDIT HERE WAS NOT "OBTAINED BY" THE ALLEGED FRAUD, PETITIONERS HAVE FAILED TO MEET THE PROXIMATE CAUSE REQUIREMENT OF 523(a)(2)(A)

The extension of credit in this case was not "obtained by" the alleged fraud by Mans and therefore does not meet the requirements of Subsection (a)(2). The purpose of Section 523(a)(2)(A) is to protect creditors who have been misled by debtors and who have made their decision to extend credit to the debtor *based upon that fraudulent information*. Thus, the fraud must cause the creditor to extend the credit. This causation requirement is contained in the express language of the statute, which overrides the usual discharge only "to the extent [the credit is] *obtained by* false pretenses, a false representation or actual fraud . . . . "

Thus, because causation is a necessary element in proving fraud, if the fraud occurred only after the extension of credit, subsection (2)(A) would not apply. It is well established that "the fraud which is necessary to prevent the effect of a discharge must be present at the inception of the debt." Collier on Bankruptcy ¶523.03 (1995). *See also, In re Geyen*, 11 B.R. 70, 72 (Bankr. W.D.La. 1981) ("if the property was obtained prior to the making of any false representations, subsequent misrepresentations will have no effect upon the discharge of the debt.")

In the instant case, Petitioners never even claimed that Mans misrepresented something when they extended the credit. Rather, the Fields have pursued their claim solely on the basis of the *subsequent* implied misrepresentation.

The facts are clear that there was *no* extension of credit at or after the "implied misrepresentation." The due date of the note was unchanged, and no new credit was extended.

CONCLUSION

The decision of the Circuit Court should be affirmed, on either the ground of the decision below or on the alternate ground that no extension of credit was obtained by fraud.

Even if this Court does not affirm, it should remand to the lower courts for factual findings on the proximate cause issue.

Respectfully submitted,

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STATEMENT OF INTEREST OF *NACBA* AS AMICUS CURIAE

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 500 consumer bankruptcy attorneys nationwide. Member attorneys and their law firms represent debtors in an estimated 100,000 bankruptcy cases filed each year. NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues which can not adequately be addressed by individual member attorneys. NACBA is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

The NACBA membership has a vital interest in the outcome of this appeal. NACBA members primarily represent individual low- and moderate-income wage-earners. Most of the cases arising under 11 U.S.C. § 523(a)(2)(A), the provision at issue in this case, are cases brought by corporate creditors against these individual consumer debtors for alleged fraud in

connection with obtaining consumer credit. A requirement of "reasonable reliance" in the elements of proof under § 523(a)(2)(A) is essential to prevent sophisticated corporate creditors from asserting meritless claims of fraud against comparatively unsophisticated debtors.

Additionally, NACBA membership is gravely concerned about creditor misuse of the economic leverage which a meritless claim of fraud can create in a consumer bankruptcy case. Since most consumer debtors are in the throes of financial difficulties, they face a significant financial hardship in defending an action asserting nondischargeability. Many debtors therefore default or consent to relief in dischargeability litigation. Creating a standard of proof for fraud which does not include reasonable reliance, despite the overwhelming consensus in the common law in favor of some form of objective requirement, would undoubtedly create additional cases in which creditors pursue nondischargeability litigation in the bankruptcy process for economic leverage alone.

This brief will present material which may not otherwise be available to the Court. NACBA members are concerned that since the debtor/respondent was not represented by an attorney in the courts below, he may not have developed the full range of arguments which would support the debtor position.

To a large extent, the case before the court is anomalous because it involves relatively unsophisticated individual creditors asserting fraud against another individual. NACBA members see the far more common use of the same provision by corporate creditors and have an interest in making the court aware of that context for the issues present in this case.

SUMMARY OF ARGUMENT

Affirmance of the First Circuit Court of Appeals is mandated by this court's prior decision in Grogan v. Garner, 498 U.S. 279 (1991) and the common law elements required to prove a cause of action for fraud. Since neither the plain language of the statute, nor the legislative history makes clear Congress' intentions concerning the elements of fraud under 11 U.S.C. § 523(a)(2)(A), the Court, as in Grogan, must interpret

the meaning of Congressional silence. The elements of fraud at common law unquestionably and overwhelmingly include an objective standard for reliance. If Congress had intended a different standard for proof of fraud when that cause of action is incorporated by reference in the Bankruptcy Code, it would have said so.

Although there are a variety of formulations of the common law objective standard for proof of reliance including "reasonable reliance", "justifiable reliance", and "the right to rely", each formulation is directed at establishing that there is a genuine causal connection between the statement made and the injured party's course of action. If this Court eliminates an objective standard for proof of fraud from section 523(a)(2)(A), bankruptcy court would be the only forum where reliance is evaluated entirely subjectively. The bankruptcy process would therefore become a disadvantage to some debtors.

The petitioners' main argument is logically untenable. The inclusion of the term "reasonably relied" in section 523(a)(2)(B), taken together with the absence of that language in

section 523(a)(2)(A), cannot express Congressional intent that reasonable reliance is to be excluded as an element for proof of fraud in cases under section 523(a)(2)(A). Section 523(a)(2)(A) applies to " ... false pretenses, a false representation or actual fraud ..." without an enumeration of the elements of those common law claims. Section 523(a)(2)(B), on the other hand, enumerates the elements of a statutory creation of the Bankruptcy Code. It includes not only an express reasonable reliance requirement, but also a <u>materiality</u> requirement and an <u>intent</u> requirement among others. What the petitioners miss is that the same analysis could equally well be applied to <u>materiality</u> and <u>intent</u> since these are expressly mentioned in section (a)(2)(B), but not (a)(2)(A). The petitioners' analysis would create a standard for proof of fraud not only without reasonable reliance, but also without materiality and without intent to deceive.

An objective standard for proof of reliance is also consistent with policy considerations. While bankruptcy relief is intended for the honest debtor, the common law ultimately

does not punish statements on which no party should reasonably rely. This protects against blind reliance on the category of misstatements which a reasonable person would ignore and helps prevent claims of fraud by plaintiffs who did not actually change their course of action based on the purportedly false representation. The objective standard thus protects honest debtors from creditors making unsupported claims of fraud.

Additionally, as the Court noted in Grogan, bankruptcy administration is facilitated by use of a standard for proof of fraud in bankruptcy which is as consistent as possible with the standard used under the common law in other courts. Consistent standards maximize the opportunities for collateral estoppel.

Finally, reasonable reliance for proof of fraud is required to protect the honest debtor from the dishonest creditor. Creditors should not be permitted to use the economic leverage of a dischargeability complaint (and the costs of its defense) unless they can prove that fraud was committed under

a standard which would be cognizable in courts outside the bankruptcy process.

ARGUMENT

I. THE ELEMENTS REQUIRED TO ESTABLISH FRAUD CANNOT BE DETERMINED BASED ON THE LANGUAGE OF THE BANKRUPTCY CODE OR THE LEGISLATIVE HISTORY; NEITHER SOURCE PROVIDES ANY BASIS ON WHICH TO DETERMINE WHETHER REASONABLE RELIANCE IS REQUIRED AS AN ELEMENT OF FRAUD FOR THE PURPOSES OF THE BANKRUPTCY CODE.

A. The terms, "false pretenses, a false representation, or actual fraud," do not have a plain meaning independent of their common law elements.

The first principle of statutory construction is "that statutory interpretation begins with the language of the statute itself." Pennsylvania Dept. of Public Welfare v. Davenport, 495 U.S. 552, 557-58 (1990) citing Landreth Timber Co. v. Landreth, 471 U.S. 681, 685 (1985). However, in this case, the plain language does not elucidate the meaning of the statute on the question before the Court. Congress' use of the terms "false pretenses", "false representation", and "fraud" provides

no guide to the elements which Congress intended as the requisites for proof of those claims.

The mere omission of the words "reasonable reliance" from subsection (A) does not indicate that Congress intended to eliminate the reasonable reliance element of common law fraud from subsection (A) claims.[1] Section 523(a)(2) contains no language that supports petitioners' assertions to the contrary.

The formulation of subsection (A) is inherently different from that of subsection (B). Subsection (B) describes a

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[1] **Section 523(a)(2) provides in pertinent part that a debtor is not entitled to be discharged from any debt to the extent that the debt was obtained by:**

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing--
(i) that is materially false;
(ii) respecting the debtor's or an insider's financial position
(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
(iv) that the debtor caused to be made or published with intent to deceive;

* * *

statutorily defined claim which expressly enumerates elements because there is no common law correlate limited to false statements in writing. By contrast, subsection (A) incorporates by reference causes of action at common law. Elements must be supplied to give effect to the subsection (A) claims.

As the court recognized in Grogan v. Garner, 498 U.S. 279, 286 (1991), in a related context, Congressional silence suggests that Congress did not intend an unusual standard for proof of fraud which departs from the legal norm. Well defined common law standards thus become the natural source for identifying the appropriate elements of proof.

As discussed more fully below in Section II, a requirement of reasonable reliance is indisputably an element of proof of fraud at common law. Congress incorporated reasonable reliance *and other common law* elements of fraud into its formulation of subsection (B). There is no logic to petitioners' position that use of common law terms in subsection (B) in defining a claim which amounts to a type of fraud, is evidence that Congress did not intend to include similar

common law elements when referencing "actual fraud" in subsection (A). If anything, Congress' awareness of the common law standard for fraud in formulating subsection (B) suggests that Congress intended incorporation of those elements when it referenced the common law claim directly.

B. The legislative history provides no guide to Congressional intent behind the statutory language on the question of whether proof of fraud requires proof of reasonable reliance.

1. There is no support in the legislative history for petitioners' position; Congress was entirely silent with regard to reasonable reliance under 11 U.S.C. § 523(a)(2)(A)

It is appropriate to turn next to the legislative history as a guide to Congressional intent. See Dewsnup v. Timm, 502 U.S. 401 (1992).

Despite petitioners' attempts to imply content from a sketchy legislative record, on careful reading the record is entirely silent as to the elements required to establish the claims referenced in subsection (A). Although there are two references to "reasonable reliance" in the record and both apply to Subsection (B), neither reference is made in a context which

limits the elements of the common law causes of action included in subsection (A).

The first reference to reasonable reliance is expressly limited to "a false statement in writing" and is applicable only to subsection (B).[2] This immediately follows a related statement that "actual fraud is added as a grounds for exception from discharge". The elements of the "actual fraud" claim are nowhere described or otherwise limited.

Contrary to petitioners' position, it is impossible to draw any conclusion about the subsequent reference in the record to codifying "case law", because that statement is logically attached only to the previous sentence on "false statements in writing". The reference to existing "case law" could not potentially relate to the term "actual fraud", because

[2] "This provision is modified only slightly from current section 17(a)(2). First, "actual fraud" is added as a grounds for exception from discharge. Second, the creditor must not only have relied on a false statement in writing, the reliance must have been reasonable. This codifies case law construing this provision. Third, the phrase "in any manner whatsoever" that appears in current law after "made or published" is deleted as unnecessary. The word "published" is used in the same sense that it is in slander actions." H.R. Rep. No. 595, 95th Cong., 1st Sess. 364 (1977); S.Rep. No. 989, 95th Cong. 2d Sess. (1978).

that term was being added to the Code in 1978. Prior case law could not have addressed the elements of a newly created exception to dischargeability.

The second legislative reference acknowledges that "[t]he courts have recently begun to require that the reliance be reasonable." H.R. Rep. No. 595, 95th Cong., 1st Sess. 130 (1977). That statement is contained entirely within a discussion of false statements in writing and cannot logically be interpreted expressly or impliedly to limit the elements of claims under other subsections. Again, what courts had or had not previously required could have no bearing, by implication or otherwise, on a newly created provision of the Code.

Petitioners and their amicus stretch mightily to give content to the legislative history by suggesting that Congressional discussion of reasonable reliance as an element under subsection (B), without a comparable discussion about reasonable reliance under subsection (A), is an indication of an intent to exclude that element of fraud under subsection (A). The proposed negative inference, however, is undermined by

the complete absence of any discussion of the elements of claims under subsection (A). Congress was not undertaking a comparative analysis. The claims referenced in subsection (A) cannot be given content without reference to their common law elements.[3]

"If anything, the legislative history suggests that Congress believed it was codifying case law under § 17a(2) requiring reasonable reliance." In re Paolino, 89 B.R. 453, 462 (Bankr.E.D.Pa. 1988). Given the state of the common law of

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[3] The amicus supporting petitioner's position asserts that if an objective standard of reliance is included as an element of fraud under section (A), then there would be no reason for the existence of section (B). That is not the case. The term "fraud", without more, is a reference to a claim at common law with the variety of elements and interpretations which the common law, by its nature, establishes. By delineating elements under section (B), Congress gave content to a claim independent of the common law.

This case represents a good example of the distinction between these two methods of drafting and suggests the reasons why Congress used both methods in the same section. Fraud at common law includes an objective standard which is enunciated by a variety of courts in a variety of ways. That requirement evolves with the common law. Where "fraud" is incorporated by reference in the Code, collateral estoppel from a variety of jurisdictions with a variety of formulations for fraud is possible. On the other hand, elements of the claim in section (B) are fixed by Congress so that no alternative standard is possible. Congress was obviously concerned about lower standards for proof of fraud being applied in some Courts.

fraud and its inclusion of an element requiring reasonable reliance at the time of Congress' enactment of the Bankruptcy Code, Congress would have had to denounce this case law expressly if it intended for it to be legislatively overruled. See Kelly v. Robinson, 479 U.S. 36, 47 (1986), citing Midlantic National Bank v. New Jersey Dept. of Environmental Protection, 474 U.S. 494 (1986). The legislative record provides no indication that Congress wanted to eliminate the reasonable reliance requirement for bankruptcy dischargeability actions based in fraud.[4]

2. There was no clear position on this issue in pre-Code case law which Congress was codifying in drafting section 523(a)(2)(A).

The question before the court cannot be decided based on Congress' inferred knowledge of pre-code case law. See Kelly v. Robinson, supra at 47. There was no clear position on the question of whether reasonable reliance was required as an

[4] The legislative history taken as a whole indicates a strong Congressional intention to enhance the discharge provision rather than to cut it back. See generally, H.R. No. 95-595, p. 128 (1977). It is inconsistent with an enhanced discharge to provide for nondischargeability for fraud without reasonable reliance.

element of proof of fraud for dischargeability purposes, except in cases involving false statements in writing.

Prior to 1979, decisions generally did not provide enough information to establish whether the courts would have required reasonable reliance in a cause of action for fraud. The predecessor statute, Bankruptcy Act § 17(a)(2), was not divided into two parts, although the majority of reported pre-code cases are § 523(a)(2)(B) type cases because they involved allegations of a false statement in writing. E.g., In re Taylor, 514 F.2d 1370, 1372-73 (9th Cir. 1975); In re Adams, 368 F. Supp. 80, 81 (D. S.D., 1973); In re Dolnick, 374 F.Supp. 84, 90 (N.D. Ill., 1974).

The petitioners rely on a 9th Circuit decision from 1978 as an example of a pre-code case which did not require the creditor's reliance to be reasonable. In re Houtman, 568 F.2d 651, 655 (9th Cir. 1978). This case exposes the weakness of petitioners' argument on this point. Most importantly, the House Reports documenting the congressional record are dated 1977 and Houtman was decided on January 25, 1978. Congress could

not possibly have been aware of the Houtman decision in evaluating the proposed language of section 523(a)(2).[5]

Moreover, Houtman merely lists the requirements for proof of fraud as taken from Taylor, supra at 1373. The Taylor case, in turn, involved a false statement in writing. Neither Taylor nor Houtman discusses the issue before the court today. In fact, a later case has interpreted Houtman as requiring reasonable reliance. Carini v. Matera, 592 F.2d 378, 380-81 (7th Cir. 1979). The same Circuit Court which had decided Houtman later required proof of justifiable reliance, despite Houtman, in a case involving fraud under section 523(a)(2)(A). In Re Kirsh, 973 F.2d 1454 (9th Cir. 1992). Regardless, Houtman was not a pre-Code statement of the standard for proof of fraud on which Congress could have relied on in codifying section 523(a)(2).

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[5] Congress was presumably equally unaware of post-enactment cases which *do* require reasonable reliance as a prerequisite to proof of fraud in bankruptcy. See Carini v. Matera, 592 F.2d 378, 380-81 (7th Cir. 1979).

In general, the cases which consider the issue do require reasonable reliance for proof of fraud under pre-Code law. See Matter of Garman, 625 F.2d 755, 759 (7th Cir. 1980) (list of citations).[6] However, since 17a(2) was not divided into subsections and since "actual fraud" was first added to the Code in 1978, it is difficult to divine the effect of this case law on Congressional thinking in drafting the Code.

The reference to case law on the reliance requirement in the legislative history is an acknowledgement that courts were beginning to require "that the reliance be reasonable." H.R. Rep. No. 595, 95th Cong., 1st Sess. 130 (1977). If anything, this supports the position that Congress was aware of the common law basis for this emerging case law. Given Congressional silence on the issue of reasonable reliance in proof of "actual fraud", it makes little sense to assume that Congress was unaware of the impact of this case law in the

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[6] A case decided by this Court which discusses pre-Code law on these issues does not meaningfully address the question of reasonable reliance. In that case reliance appears to have been assumed. Morimura, Arai, & Co. v. Taback, 279 U.S. 24 (1928).

context of section 523(a)(2)(A) where it chose not to codify specific elements to establish proof of fraud.

C. The Circuit Court in Ophaug incorrectly concluded that by including a requirement of reasonable reliance in section 523(a)(2)(B), Congress was, by implication, excluding that requirement from section 523(a)(2)(A).

The 8th Circuit Court of Appeals erroneously concluded that under § 523(a)(2)(A) creditors were not required to act reasonably when relying on misrepresentations made by consumers seeking credit. In re Ophaug, 827 F.2d 340, 341 (1987).

The Ophaug Court erred in finding the statute to be clear on its face. As discussed above, the language of § 523(a)(2) is not specific enough to determine congressional intent. In its plain language argument, the Ophaug Court asserts that the inclusion of a requirement of reasonable reliance in subsection (B) together with its omission in subsection (A) was intended by Congress to exclude the reasonable reliance element of common law fraud from all claims under subsection (A).

Use of this line of argument for analysis of § 523(a)(2) is inherently flawed. As discussed above, subsection (B) sets out elements of a statutorily created claim, while subsection (A) merely references common law causes of action. Subsection (B) thus expressly includes a requirement of materiality and a requirement of "intent to deceive" in addition to the requirement of reasonable reliance. These same elements are not included in subsection (A). Following this logic of the Ophaug court, one would have to assume that Congress intended to eliminate the materiality and intent elements of common law fraud from subsection (A) since they are incorporated in subsection (B), but not in (A). This would leave a cause of action for fraud under subsection (A) essentially without elements of proof-- a result which is obviously contrary to the intent of Congress. As discussed below in Section II, common law is the only reasonable means of determining the standard of reliance required under § 523(a)(2)(A).

Further, the Ophaug Court erred in asserting that the reasonableness requirement was an additional burden placed on

§ 523(a)(2)(B) creditors. Ophaug, at 343. Since no similar express provision was added to subsection (A), the court concluded that Congress omitted the requirement so as not to "give additional support to debtors by imposing a reasonableness requirement in §523(a)(2)(A)." Ophaug, at 343, citing In re Fosco, 14 B.R. 918, 922 (Bankr. D. Conn. 1981). This argument is flawed in that there was no additional requirement being imposed by Congress specifically for subsection (B). The legislative record with respect to the reasonable reliance requirement is clear; Congress intended to "codif[y] the [existing] case law construing this provision." H.R. Rep. No. 595, 95th Cong., 1st Sess. 364 (1977).

II. THE DETERMINATION OF THE LEGAL PREREQUISITES FOR PROOF OF FRAUD MUST BE TAKEN FROM THE COMMON LAW; THE COMMON LAW INCLUDES REASONABLE RELIANCE AS AN ELEMENT OF PROOF OF FRAUD

A. In the absence of Congressional guidance, terms originating in the common law such as fraud, false pretenses and false representation can only be defined by reference to the common law.

In a recent case, this Court evaluated the appropriate standard of proof for dischargeability cases based on fraud and concluded that because Congress was silent on the question, the more generally applicable preponderance of the evidence standard should apply. Grogan v. Garner, 498 U.S. 279, 286 (1991). Grogan is based on the principle that, where the language of the statute does not prescribe a standard and the legislative history is silent, the Court cannot imply that Congress intended a standard of proof which differs from the norm. Id. at 286.

The issues before the Court here are similar. As discussed immediately below in Subsection B.1., virtually every state jurisdiction and the leading commentators agree that the common law standard for proof of fraud requires proof of reasonable or justifiable reliance. This objective standard allows the fact finder to apply a test which fairly evaluates whether there is a genuine causal relationship between the alleged false statement and the complainants' course of conduct in reliance. Since Congress was entirely silent about the

elements under section 523(a)(2)(A), the Court should not imply that Congress intended a novel standard for proof of fraud to be applied.

Similarly, a requirement of reasonable reliance "reflects a fair balance between . . . conflicting interests." Grogan, at 287. As in Grogan, to assert that Congress intended a special standard of proof would be to assume that it intended to tip the established balance for proof of fraud in favor of one party over another. It is not reasonable to conclude that "Congress silently endorsed a background rule," to apply a special standard of proof. Grogan, at 290. After Grogan, the only appropriate method for determining the applicable elements of proof of fraud under §523(a)(2)(A) is to apply the normal legal elements of proof of fraud as developed in the common law.

B. The common law requires an objective standard for the requisite reliance to establish fraud; this is most often termed "reasonable reliance."

1. Although it is expressed in a variety of ways, an objective standard for reliance has long been part of the common law for proof of fraud.

The restatements, treatises, and the case law all conclude that an objective standard for reliance is required to establish fraud. These sources of primary and secondary law use various terms to state the principle that reliance alone is insufficient to establish fraud, but their conclusion is the same: "the reasonableness of a creditor's reliance will be evaluated according to the particular facts and circumstances present in a given case." In re Mullet, 817 F.2d 677, 679 (10th Cir. 1987).

The common law rule is that "the recipient must not only in fact rely upon the misrepresentation, but his reliance must be justifiable." Restatement (Second) of Torts § 537 cmt. b, (1978). *See also*, W. Page Keeton et al., Prosser and Keeton on the Law of Torts § 108, at 749 (5th ed. 1984) ("Not only must there be reliance but the reliance must be justifiable under the circumstances.").

This general rule is now followed universally for proof of fraud in state courts. A sampling of relatively recent case law is instructive. Some courts call the relevant standard

"reasonable reliance".[7] Others refer to a "justifiable reliance".[8] Still other courts refer to a "right to so

[7] Synergistic Technologies, Inc. v. IDB Mobile Communications, Inc., 871 F.Supp. 24 (D.D.C. 1994); Sazerac Co., Inc. v. Falk, 861 F.Supp. 253 (S.D.N.Y. 1994); Peach State Meat Co. v. Excel Corp., 860 F.Supp. 849 (M.D.Ga. 1994); DeBry v. Noble, 889 P.2d 428 (Utah 1995); R.R.S. II Enterprises Inc. v. Regency Associates, 646 N.E.2d 56 (Ind.App. 4 Dist. 1995). See also, e.g., American Safety Equipment Corp. v. Winkler, 640 P.2d 216, 224 (Colo. 1982); Lock v. Schreppler, 426 A.2d 856, 863 (Del.Super 1981); Stewart Title of Idaho, Inc. v. Nampa Land Title Co., Inc., 715 P.2d 1000, 1002 (Idaho 1986); Bernan v. Gurwicz, 189 N.J.Super. 89 (1981); Sippy v. Cristich, 4 Kan.App. 2d 511 (Kan. 1980); Southern States Ford, Inc. v. Proctor, 541 So.2d 1081, 1092 (Ala. 1989); Radford v. J.J.B. Enterprises, Ltd., 163 Wis.2d 534 (Wis.App. 1991); Sugarline Associates v. Alpen Associates, 155 Vt. 437 (Vt. 1980).

[8] E.g., In re Harris Pine Mills, 44 F.3d 1431 (9th Cir. 1995) (Oregon law); Bank of the West v. Valley Nat. Bank of Arizona, 41 F.3d 471 (9th Cir. 1994) (California law); Sudul v. Computer Outsourcing Services, 868 F.Supp. 59 (S.D.N.Y. 1994); Mulgrew v. Sears Roebuck & Co., 868 F.Supp. 98 (E.D.Pa. 1994); Chimento Co., Inc. v. Banco Popular de Puerto Rico, 617 N.Y.S.2d 157 (A.D. 1 Dept. 1994); Perez Trucking, Inc. v. Ryder Truyck Rental, Inc., 886 P.2d 196 (Wash.App.Div.3 1994); Eckholt v. American Business Information, Inc., 873 F.Supp 510 (D.Kan. 1994); Masters v. San Bernardino County Employees Retirement Ass'n, 37 Cal.Rptr.2d 860 (Cal.App. 4 Dist. 1995); Thor Bear, Inc. v. Crocker Mizner Park, Inc, 648 So.2d 168 (Fla.App. 4 Dist. 1994); Maddox v. Southern Engineering Co., 453 S.E.2d 70 (Ga.App. 1994); McGough v. Gabus, 526 N.W.2d 328 (Iowa 1995).

rely".[9] This last standard is indistinguishable from justifiable reliance in its application. E.g., Hereford v. Unknown Heirs, 315 S.W. 2d 412, 421 (Mo. 1958) (right to rely equated with justifiable reliance).

The rationale for these decisions is to provide some objective way to measure actual reliance and to prevent fraud claimants from asserting that they altered their course of conduct based on a statement and a set of circumstances which do not objectively suggest that they were actually misled. A reasonable reliance requirement provides "some objective corroboration that [the claimant] did rely". Prosser at § 108, 749-750.

Similarly, most of the Circuit Courts which have considered the issue have made some form of objective reliance requirement an element of fraud for the purpose of

[9] Elsberry v. Boulevard Motors, Inc., 886 S.W.2d 732 (Mo.App.E.D. 1994); Cottonhill Inv. Co. v. Boatmen's Nat. Bank of Cape Girardeau, 887 S.W.2d 742 (Mo.App. S.D. 1994); Hansen v. DHL Laboratories, Inc., 450 S.E.2d 624 (S.C.App. 1994).

nondischargeability in bankruptcy.[10] Even the petitioners' brief, which lists a number of decisions for and against a reasonable reliance requirement, supports an assertion that the majority of case law dictates an objective standard of reliance. Petitioners' Brief at 14-15, n.5-6. The requirement of reasonable or justifiable reliance for the purpose of proof of fraud serves the same purpose in bankruptcy as it does outside bankruptcy. See, e.g., Matter of Garman, 625 F.2d 755, 759 (7th Cir. 1980) ("reasonableness is circumstantial evidence of actual reliance").[11]

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[10] Commerce Bank & Trust Co. v. Burgess, 955 F.2d 134, 140 (1st Cir. 1991); In re Ledford, 970 F.2d 1556, 1559 (6th Cir. 1992); In re Kimzey, 761 F.2d 421, 423 (7th Cir. 1985); Carini v. Matera, 592 F.2d 378, 380-81 (7th Cir. 1979); In re Kirsh, 973 F.2d 1454, 1457-58 (9th Cir. 1992); In re Mullet, 817 F.2d 677, 679 (10th Cir. 1987). In re Hunter, 780 F.2d 1577, 1579 (11th Cir. 1986).

[11] One question which is presented to some extent by the facts of this case is whether a reasonable reliance requirement may include a duty to investigate. The Seventh Circuit Court of Appeals, which had previously required reasonable reliance as an element of fraud, recently concluded that such a requirement does not generally include a duty to conduct a thorough investigation. Matter of Mayer, 51 F.3rd 670 (7th Cir. 1995). That conclusion is consistent with the common law which generally does not include a duty to investigate except to the extent that failure to investigate (continued...)

Additionally, New Hampshire, the state in which this case originated, requires a reasonable reliance standard for proof of common law fraud. "In order to prove deceit, the plaintiff must prove that the defendant intentionally made material false statements to the plaintiff, which the defendant knew to be false or which he had no knowledge or belief were true, for the purpose of causing, and which does cause, the plaintiff *reasonably* to rely to his detriment." Caledonia, Inc. v. Trainor, 123 N.H. 116, 459 A.2d 613 (1983).

2. The appropriate objective standard can best be expressed through a requirement framed as "reasonable reliance."

Reasonableness is an objective standard of behavior which compares the actions of the creditor to a that of a reasonable person. Although courts use a variety of terms for

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[11](...continued) represents a deliberate closing of one's eyes to the actual facts. See Prosser, supra. The Court need not decide the question of the extent of an appropriate investigation, but may rather express the view consistent with the commentators that reasonableness should be considered in light of the circumstances, the available information and the relationship of the parties. In certain situations, a fact finder may conclude that the circumstances would trigger a reasonable person to investigate.

this objective standard, the common aim is to determine whether reliance was appropriate given the circumstances of the transaction. Compare, e.g., In re Kirsh, 973 F.2d 1454 (9th Cir. 1992) (requirement of "justifiable reliance" is one which takes into account the knowledge and relationship of the parties) with In re Mullet, 817 F.2d 677, 679 (10th Cir. 1987) ("the reasonableness of a creditor's reliance will be evaluated according to the particular facts and circumstances present in a given case.") As the Ninth Circuit noted in Kirsh, "[t]his use of the word 'reasonable' in place of 'justifiable' is of no real moment unless a later reader is led away from the true content of the reliance element. Kirsh, supra at 1459.

Nevertheless, use of the term "reasonable" appears to represent the more common articulation of the standard. It is also the term chosen by Congress in setting out elements (obviously derived from common law) for a statutory cause of action for fraud based on a false financial statement. Since "reasonable" and "justifiable" reliance are virtually interchangeable in the common law, there is no good reason in

bankruptcy to create confusion by articulating one standard under section 523(a)(2)(A) and another under section 523(a)(2)(B).

3. Petitioners' position leads to an illogical result which is contrary to hundreds of years of development of the common law of fraud.

Reasonable reliance is a tool for the finder of fact. A requirement of reasonable reliance provides a gauge for measuring both materiality of the misrepresentation and actual reliance, two elements of common law fraud.

Where reliance is found to be reasonable in the circumstances, then the materiality element must also be satisfied. "Reliance upon a fraudulent misrepresentation is not justifiable unless the matter misrepresented is material." Restatement (Second) of Torts § 538(1) (1976). Likewise, where reliance is reasonable, it is much more likely that actual reliance does in fact exist. "If plaintiff can claim reliance on the basis of the kind of statement on which no reasonable person would rely for one reason or another, then it is quite likely that plaintiff did not rely." W. Page Keeton et al.,

Prosser and Keeton on the Law of Torts §108, at 750 (5th ed. 1984).

If petitioners' position is adopted, it would lead to the absurd result that fraud based on a writing would be harder to establish than fraud based on an oral statement. Where there is a writing, there is direct evidence of the claimed misrepresentation which can contribute to a fact finder's conclusions about the impact of that misstatement on the party asserting fraud. Absent the writing, fraud is harder to pin down and the tool of evaluating the reasonableness of reliance has additional uses. Eliminating reasonable reliance from evaluation of fraud based on oral statements would inappropriately undermine the process which the common law has created to find the truth.

III. A "REASONABLE RELIANCE" REQUIREMENT UNDER SECTION 523(a)(2)(A) IS CONSISTENT WITH A VARIETY OF BANKRUPTCY POLICIES, AND CREATES EFFICIENCY FOR THE ADMINISTRATION OF JUSTICE.

A. Use of a common law standard for fraud including reasonable reliance increases the potential

for cases to be resolved based on collateral estoppel because the same standard will be used in state and federal courts.

The use of a reasonable reliance standard in common law proof of fraud is so pervasive as to be nearly universal. By incorporating it into bankruptcy law proof of fraud under § 523(a)(2)(A), opportunities for collateral estoppel will be enhanced when dischargeability claims are tried, but the underlying claims are not ultimately liquidated in the bankruptcy process.

The Court in Grogan recognized the value to the judicial system of creating a common standard for proof of fraud so that claims litigated in one forum can be established by collateral estoppel in another. Grogan, supra, at 284-285. The Grogan case presented one paradigm, that is a claim liquidated under a particular evidentiary standard outside bankruptcy, where collateral estoppel is sought in a later bankruptcy action to determine dischargeability of the debt. Id. at 281-282.

This case presents a different paradigm; that is the debt is unliquidated at the time of bankruptcy, its dischargeability

can be decided in bankruptcy, but the parties may have to return to state court in order to liquidate the amount of the claim. Under this paradigm, it makes little sense to have a bankruptcy court evaluate whether a debt is nondischargeable, based on evidence which may not ultimately establish that there is a debt at all in state court. See In re Paolino, 89 B.R. 453, 462 (Bankr. E. D. Pa. 1988). If the state law standard and the bankruptcy standard are the same, the bankruptcy nondischargeability judgment would establish liability in the later state court case by collateral estoppel.

Furthermore, unlike the situation in Grogan, a rule which requires reasonable reliance for proof of fraud would not be at variance with the law of other jurisdictions. It would therefore not preclude application of collateral estoppel in bankruptcy to state court judgments based on fraud.

Particularly, as here, where the law requiring an objective standard for proof of reliance is pervasive in nonbankruptcy courts, no useful purpose can be served by

establishing a different standard in the federal bankruptcy system.

B. A reasonable reliance requirement is consistent with the principle that exceptions to dischargeability be narrowly construed; a principle which Congress understood was in place when it passed the Bankruptcy Code.

It is well established precedent that exceptions to discharge be narrowly construed. Gleason v. Thaw, 236 U.S. 558 (1915). See also, In re Leichter, 197 F.2d 955 (3rd Cir. 1952). That principle is consistent with the importance of the discharge available under the Bankruptcy Code and the policies which support it. Local Loan Co. v. Hunt, 292 U.S. 234 (1934). These principles had been so long held at the time of the passage of the Bankruptcy Code, that Congress must be held to have been fully aware of them when the new law was passed in 1978. Kelly v. Robinson, 479 U.S. 36, 47 (1986). In addition, Congress was unequivocal about the importance of the discharge. See also H.R. No. 95-595, p. 128 (1977) ("Perhaps the most important element of the fresh start for a consumer debtor after bankruptcy is discharge. ... H.R. 8200 proposes to

remedy the deficiencies in the current discharge provisions and to make the discharge effective relief for consumer debtors.")

A statutory construction which obligates debtors for nondischargeable claims on proof which would be insufficient to establish that same claim in state court would be entirely inconsistent with narrow construction of exceptions to discharge and with Congressional intent to enhance the discharge. In fact, for some debtors, bankruptcy and the relief it is intended to offer would actually become a disadvantage. That is because they might be found liable absent reasonable reliance by their creditor, even though that creditor could not establish a debt based on fraud in a nonbankruptcy court.

C. A reasonable reliance requirement will discourage frivolous and/or dishonest claims of fraud by creditors and will reduce claims by issuers of consumer credit based on debtor conduct which had nothing to do with the reasons credit was granted.

As discussed above, the purpose of a reasonable reliance requirement, as it has developed in the common law, is to help identify legitimate claims in which the complainant was actually relying on a material misstatement of a relevant fact. Over

time, the common law has developed a principle which prevents fraud plaintiffs from asserting that they were harmed by statements which, in the circumstances, they did not accept or should not have accepted at face value.

The case before the Court presents the unusual situation in which the plaintiffs in a nondischargeability proceeding are individuals. The vast majority of nondischargeability claims in the bankruptcy process are raised by large corporate creditors against individual debtors.[12] Most claims involve consumer credit issued by relatively sophisticated corporate entities. The corporate creditor has a significant financial advantage in dischargeability litigation, since consumer bankruptcy debtors, because of their financial circumstances, are frequently unable to afford counsel to litigate on their behalf.[13]

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[12] The defendant in a nondischargeability action under 11 U.S.C. § 523(a) is always an individual. That section only applies to individual debtors.

[13] 11 U.S.C. § 523(d), a fee shifting provision applicable to some cases, only partially addresses creditor overreaching, since in order to take advantage of it, a debtor must pay the up front costs of litigation and prevail on grounds which establish that the creditor's position was not substantially justified. Many consumer (continued...)

Elements of proof of fraud which are less rigorous than the common law standard will inappropriately enhance the creditor advantage in the bankruptcy dischargeability litigation process. This is particularly true because sophisticated corporate creditors would be permitted to prevail in a dischargeability action even absent some objective indicia of reliance on the statements of an unsophisticated consumer debtor.

Some creditors already file multiple standard form nondischargeability actions in order to gain the economic leverage which is created by forcing the debtor to litigate an expensive claim. Reducing the standards which most courts currently apply to those cases will undoubtedly increase their number.

Additionally, several credit card issuers freely dispense credit cards with no review at all of the creditworthiness or

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[13](...continued)
debtors default or agree to relief in cases brought by unreasonable creditors because they cannot afford the up front costs of the litigation.

financial circumstances of the persons to whom the credit is issued. These creditors make a business decision not to reasonably rely on representations made by the persons to whom they issue credit, but rather expect to profit by high rates of interest spread over a large pool of borrowers. A decision in favor of petitioners' position would encourage these creditors because there would be no need in bankruptcy to establish meaningful reliance on any implied or oral statements made in the credit transaction. See generally In re Cox, 1995 WL 349089 (Bankr. D. Mass. 1995) (evaluating whether there is the requisite degree of reliance in the context of a debtor's use of a credit card).

D. A reasonable reliance requirement will not create a safe haven in bankruptcy for dishonest debtors since fraud cannot be proved anywhere without some type of objective standard applicable to the plaintiff's behavior.

In Grogan, the Court expressed concern that dishonest debtors might take advantage of the Bankruptcy Code to escape from debts which are based on their fraudulent conduct. Grogan, supra at 286-87. Certainly, some of the exceptions to

discharge are designed to protect creditors from debtors who engage in activity which society chooses to condemn.[14]

However, a more subtle question arises in determining when a particular debtor should be identified as dishonest. The common law of fraud has developed in a way which is intended to separate legitimate from illegitimate claims. Ultimately, no one is defined as dishonest by our common law unless the complainant can establish that their reliance on any statements made is reasonable or justifiable in the circumstances of the case. The principle is no less valid in bankruptcy court than in its pervasive common law application.

[14] 11 U.S.C. § 523(a)(2),(4),(6),(9),(12).

CONCLUSION

For all the foregoing reasons, NACBA urges that the decision of the Court of Appeals for the First Circuit in this case be affirmed.

Respectfully Submitted,

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